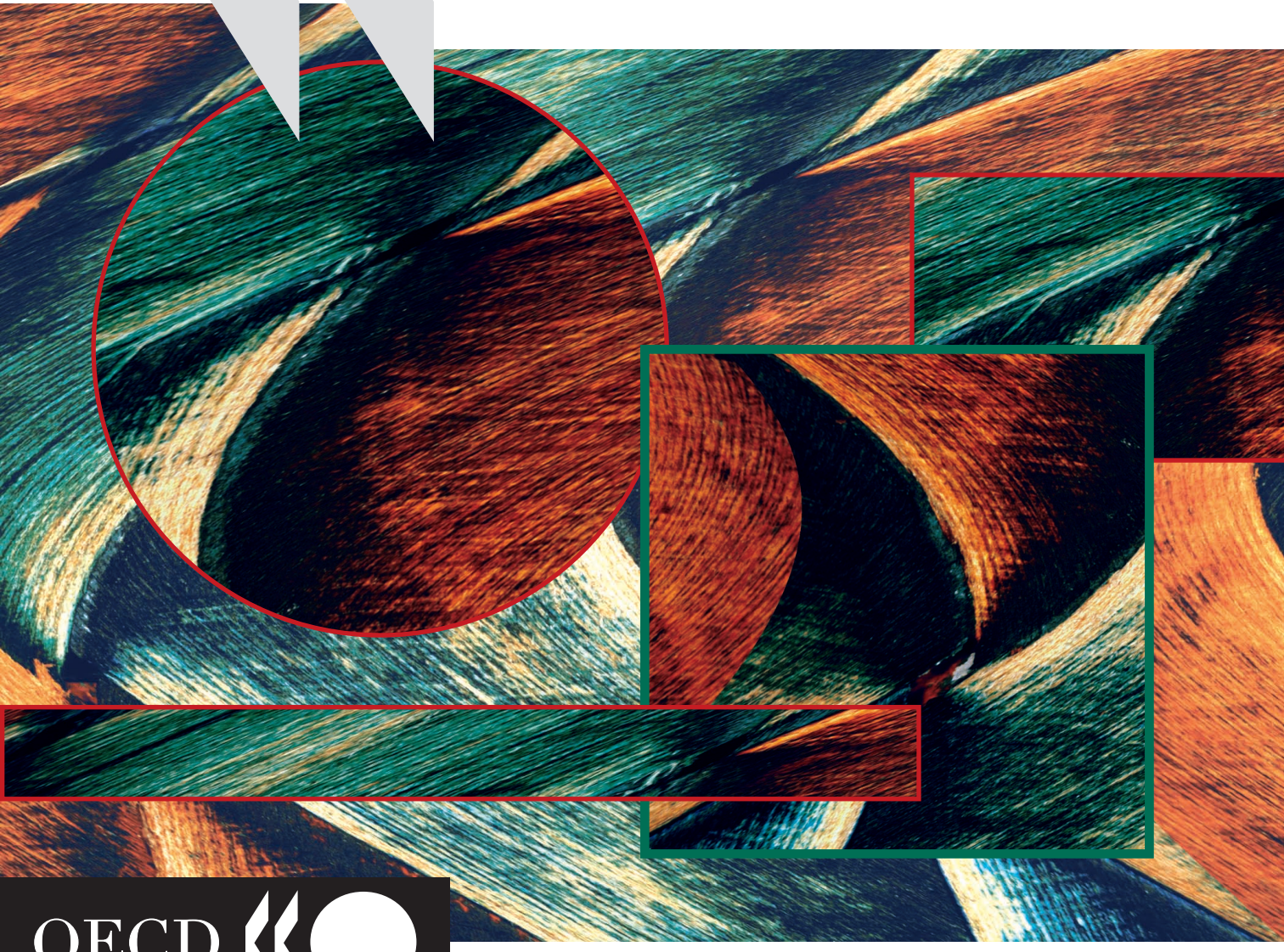
The DAC Journal



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Development **A**ssistance **C**ommittee

OECD

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

- to achieve the highest sustainable economic growth and employment and a rising standard of living in member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
- to contribute to sound economic expansion in member as well as non-member countries in the process of economic development; and
- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

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In order to achieve its aims the OECD has set up a number of specialised committees. One of these is the Development Assistance Committee, whose members have agreed to secure an expansion of aggregate volume of resources made available to developing countries and to improve their effectiveness. To this end, members periodically review together both the amount and the nature of their contributions to aid programmes, bilateral and multilateral, and consult each other on all other relevant aspects of their development assistance policies.

The members of the Development Assistance Committee are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, the United States and the Commission of the European Communities.

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FOREWORD

The OECD's Development Assistance Committee (DAC) is the key forum for bilateral donors accounting for 95% of world ODA.

Work undertaken by the DAC provides information, insights and results on development co-operation issues. The DAC Journal regroups a cross-selection of recent material which the development community at large should find informative and pertinent. Generally, the work published in the Journal is the product of the DAC or its working parties and networks. It may also emerge from DAC forums and seminars.

Each year, the first issue of the DAC Journal carries the annual Development Co-operation Report (DCR) of the DAC chairman. A basic component of subsequent issues of the Journal are the DAC Peer Review reports. An explanation of the DAC's Peer Review process precedes the publication of the peer review reports in this Journal.

The work is published on the authority of the Secretary-General of the OECD.

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Part I

Development Assistance Committee
High Level Meeting
15-16 April 2004

Abstract. The DAC High Level Meeting is a unique gathering of aid ministers and heads of aid agencies from OECD governments together with senior officials from the World Bank, the IMF and UNDP. They met in Paris on 15-16 April to review aid and security issues; aid volume and effectiveness; and the growth agenda and the MDGs. This part of the publication regroups several key outputs from the meeting.

Acknowledgements: This part of the publication contains papers prepared by the OECD Media Division, the DAC Secretariat, and DCD Statistics and Monitoring Division (DCD/STAT). Any comments or queries should be addressed to <dac.contact@oecd.org>. For more information about the DAC High Level Meeting see www.oecd.org/dac/hlm2004.

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STATEMENT ADOPTED BY MEMBERS OF THE OECD'S DEVELOPMENT ASSISTANCE COMMITTEE (DAC)

High Level Meeting, 15-16 April 2004

Development Co-operation Ministers and Agency Heads of DAC Members met in Paris on 15-16 April 2004 along with the Administrator of the UNDP, Mr Mark Malloch Brown, senior representatives of the World Bank and IMF, and of non-DAC OECD Members. The meeting was chaired by Mr Richard Manning, Chair of the DAC. They agreed on the following statement:

1. In anticipation of a high-level plenary meeting to review the implementation of the Millennium Declaration, to be held by the UN in 2005, we took stock of the trends in Official Development Assistance (ODA), noting that the real increase over the last two years has been 11 per cent, reversing the declines in aid of the previous decade. In the context of the 2002 Monterrey Conference on Financing for Development, a large number of DAC members have now set timetables for reaching an ODA/GNI ratio of 0.7% or are committed to significant increases in their ODA volume, and some members are proposing a new mechanism for financing an early doubling of development assistance.

> We agree that the consensus reached in Monterrey in 2002 and the pledges made by a large number of DAC countries, remain the basis for decisions on aid budgets in the context of tackling the internationally agreed development goals set out in the Millennium Declaration (MDGs). These pledges represent a further prospective increase in aid of around 25 per cent between 2003 and 2006. We note that while some among us are making faster than expected progress, others will need to lift ODA levels rapidly in order to meet commitments made. In addition to ODA, we reaffirmed the importance of mobilizing in a coherent manner a variety of resources, including domestic resources and foreign direct investment. We also recognise that capacity development in partner countries, and their ownership of development strategies, are essential for the achievement of the MDGs. We note that countries in the sub-Saharan Africa region face particular challenges in reaching these goals, and we are committed to supporting their own co-operative efforts, notably in the context of NEPAD.

2. We recognise the compelling need to increase the effectiveness of our aid as an integral part of the Monterrey Consensus and for delivering scaled up aid programmes to support achievement of the MDGs. We welcome the work in hand in the DAC, with the participation of the Multilateral Development Banks, the UN, and developing country partners, to turn the principles of harmonisation and alignment—agreed at the Rome High Level Forum in 2003—into reality on the ground. It is vital to see concrete results from this work, and from other parts of the aid effectiveness agenda, by the time of the follow-up Paris High Level Forum in early 2005.

> We commit our agencies and our field staff to implement the action plans that each of us has undertaken to introduce and implement as part of the follow-up to Rome. We accept that this will mean significant changes to the way our agencies and field offices manage the delivery of aid. We emphasise the need for all donors, multilateral and bilateral, as well as the global funds, to participate in harmonisation and alignment initiatives. We encourage developing

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countries to lead strong local co-ordination processes on the basis of their own development strategies and medium-term budget frameworks. We endorse the 2004 joint Marrakech Memorandum on Managing for Development Results, and the Core Principles attached to it, as a basis for consultation with developing countries. The proposed action plan should also be included in these consultations. We call for thorough preparation of the Paris High Level Forum and request the DAC Senior Level Meeting, to be held in December 2004, to identify where more progress in changing actual donor practices is needed, in the light of the report it will receive on progress since Rome.

3. We recognise the fundamental importance of broad-based economic growth to raising millions of poor people out of poverty, as demonstrated in the sustained growth in many Asian countries over recent decades. We are concerned that the growth prospects in many other countries are well below what should be attainable in today's world and well below what is needed to reach the MDGs in many poor countries, particularly in Africa. New efforts are needed to connect poor people into the growth and development process, especially the large proportion of poor people located in rural areas. Accountable and well-functioning legal and financial systems, as well as sound public management, are basic requirements.

We agree to give renewed priority to assisting partner countries to launch a dynamic growth process that decisively reduces poverty. We support the work in the DAC and elsewhere to understand better how to help generate sustained broad-based growth, through country-specific reforms which stimulate local entrepreneurship and trade capacity and create synergies between private sector development, trade, and investment in agriculture and infrastructure. Such growth strategies should be embedded in Poverty Reduction Strategies (PRS), investment in agriculture and infrastructure should receive renewed attention in this context. We also recognise the importance of assisting the emergence of a knowledge economy in developing countries. We welcome the interest and activities of other policy communities in the OECD in development co-operation, and their engagement in working for greater coherence of OECD policies impacting on trade, growth, and development prospects. We look forward to collaborating more closely with them in promoting an international environment facilitating development. Trade is key and we emphasise the importance of fulfilling the objectives of the Doha Development Declaration.

4. We recognise that security and development are inextricably linked. Conflict kills the prospects for broadbased growth. The DAC's 2001 Guidelines on Poverty Reduction identified human security as one of the five main dimensions of poverty. Without security in its broadest sense, the MDGs will not be attainable for millions of the poor. And without development, there can be no sustainable human security. There is a need for more integrated development and security policies, with greater civilian involvement and oversight of security systems. Security systems should seek to provide freedom from violence and fear. They should be people-centred, locally-owned frameworks, based on democratic principles, human rights and the rule of law. These principles are at the core of the concept of security system reform, which provides a new framework to structure co-operation to address security challenges facing states and their populations.

We endorse "Security System Reform and Governance: Policy and Good Practice", a DAC policy statement and reference paper that includes recommendations for donors to work on Security System Reform through whole-of-government approaches; strategic planning frameworks; and facilitation of reforms that are owned and led by developing country partners. We note that this guidance is in line with the conclusions of the final report of the Commission on Human Security submitted to the UN Secretary General in 2003, which we support.

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5. The question of ODA eligibility in relation to conflict prevention, peace building and security-related activities has become more significant as our Governments and our developing country partners give greater attention to issues around peace, security and development, and reflect on the best use of development funds for this purpose. At the same time, we are committed to maintaining credibility of the definition of ODA and the role of the DAC as its guardian.

> Against this background, we agreed that the definition of ODA relevant areas would need to be adjusted and clarified and we discussed a number of proposals. We decided to adjust and clarify ODA reporting guidelines relating to preventing recruitment of child soldiers, enhancing civil society's role in the security system, and civilian oversight and democratic control of the management of security expenditure. We also agreed to continue work and discussion on other items, bearing in mind the need to maintain the credibility of ODA and to protect the integrity of ODA budgets. We have asked the competent DAC bodies to report to the Senior Level Meeting in December 2004, with a view to reaching a consensus by the time of the 2005 High Level Meeting.

6. A substantial amount of ODA is devoted to humanitarian assistance, often in the context of crisis situations.

> We encourage the DAC to see how it might best contribute, in the framework of its Peer Reviews, to meeting and improving standards in the area of Good Humanitarian Donorship.

7. The case of ODA eligibility of assistance for projects that would qualify under the Clean Development Mechanism (CDM) of the Kyoto Protocol poses important issues of how to support this instrument for sustainable development, while guarding against the risks of aid diversion.

8. To conclude, we believe that, more than ever, development co-operation is a key instrument for achieving a world which offers decent and secure lives for all. As we approach the UN review in 2005, we are resolved to build on the new impetus to gear aid volume and effectiveness, as well as other development-related policies, to achieving the MDGs and to ensure that our publics are properly informed on the outcomes of these efforts.

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PRESS RELEASE

16/04/2004

Aid Ministers Note Rise in Aid Volume and Push for Aid Reform and New Approaches to Security-Development Linkages

The annual meeting of the OECD's Development Assistance Committee brought together Aid Ministers and Agency Heads, the UNDP, the World Bank and the IMF, under the Chairmanship of Mr Richard Manning, Chair of the DAC.

Mr. Manning identified the highlights of the meeting:

Aid volume rising; more needed

Aid volume has risen by a total of 11 percent over the last two years, after a decade of decline. But much more will be needed to achieve the UN Millennium Development Goals (MDGs) for 2015, including reducing the percentage of people in poverty by half, cutting child and maternal mortality, and enrolling all girls and boys in school. Existing donor pledges imply a further rise in ODA of some 25 percent by 2006, but there is no room for complacency.

Aid reform pushed forward

The Ministers reiterated their support for the collective effort, launched at the Rome Forum in February 2003, to boost the effectiveness of aid through reforms to simplify and harmonise the aid practices of bilateral and multilateral agencies and the special global funds. The key objective is to stop wasting time and money on a multiplicity of separate donor efforts, missions and reports.

Recent aid reform in Bangladesh shows the way forward. In the past, 13 donors had 27 projects for primary education, disbursed through 33 special accounts. Last year donors forged a single sector-wide approach, aligned with the Bangladeshi government's poverty reduction strategy, with common financial arrangements, joint missions and only three accounts.

Ministers and Agency Heads committed to ensuring that their agencies implemented the action plans developed, together with developing country action plans, on the basis of the Rome agenda. They agreed that a further phase of reform should be proposed for adoption at a Paris Forum, in early 2005.

A new approach to security and development linkages

The High Level Meeting adopted a policy statement on Security System Reform, which guides donor efforts to help developing countries address one of the primary causes of poverty - violent conflict and widespread public insecurity and fear. The key principle is to treat security systems overall, including the functioning of police and justice systems, civilian control of the armed forces and protection of human rights. This involves a whole-of -government approach, both in the partner country and on the donor side, in a coherent framework engaging civilian departments, the police, and the armed forces. This approach is proving successful in the Solomon Islands.

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The HLM agreed to adjust and clarify ODA definitions relating to preventing recruitment of child soldiers enhancing civil society's role in the security system; and civilian oversight and democratic control of security expenditure. Other ODA definition issues in these areas will be studied further and proposals prepared for 2005 HLM.

Economic growth is needed to help achieve the MDGs

The dynamic growth in East and South Asia has raised more people out of poverty than at any other time in history. But many developing countries around the world are not generating the economic growth needed to reduce poverty decisively and meet the MDGs. This is a complex and challenging problem and very country specific. The High Level Meeting agreed to give renewed priority to helping these countries launch a dynamic growth process. This means making broad-based growth the central goal of poverty reduction strategies; promoting synergies between the private sector, agriculture and infrastructure, including information technology and helping with financial sector development that reaches the poor. The critical role of trade in the growth process was stressed and the High Level Meeting emphasized the importance of fulfilling the objectives of the Doha Development Round.

New understanding on counting ODA for clean development mechanism projects

The High Level meeting defined a new reporting rule that would ensure consistent reporting in ODA statistics of aid provided by members to finance projects under the Clean Development Mechanism. The new rule requires that the value of any carbon credits acquired by donors should be deducted from ODA.

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ODA STATISTICS FOR 2003 AND ODA OUTLOOK

Modest Increase in Development Aid in 2003

Member countries of the OECD's Development Assistance Committee (DAC) increased their official development assistance (ODA) to developing countries by 3.9% in real terms from 2002 to 2003, following a 7.0% real increase between 2001 and 2002. These "real terms" data are adjusted both for inflation and for the large fluctuations in exchange rates over the past two years (see Table 1).

According to preliminary data total DAC ODA in 2003 reached $68.5 billion, the highest level ever, both in nominal and real terms. This total represented 0.25% of DAC members' combined gross national income (GNI), up from 0.23% in 2002 and 0.22% in 2001. Three major factors are behind the $2.3 billion rise, in real terms, in 2003:

- Continuing growth in general bilateral grants ($2 billion).
- The start of reconstruction aid to Iraq ($2 billion).
- Offset by a cyclical fall of contributions to multilateral concessional funds (-$1.2 billion) and a small decrease in net lending (-$0.5 billion).

The United States remains the world's largest aid donor in volume terms, followed by Japan, France, Germany and the United Kingdom. Denmark, Luxembourg, the Netherlands, Norway and Sweden are still the only countries to meet the United Nations ODA target of 0.7% of GNI. Three other countries have given a firm date to reach the 0.7% target: Belgium by 2010; Ireland by 2007; and France to reach 0.5% by 2007 and 0.7% by 2012.

Twelve of the 22 DAC member countries reported an increase in ODA in real terms. In 2003, the United States increased its ODA by 16.9% in real terms to $15.8 billion in 2003, representing 0.14% of its GNI. US bilateral aid jumped by $3.9 billion, including $2 billion for Iraq, partly offset by a $1.4 billion fall in US multilateral aid due to the timing of capital subscriptions to international financial institutions.

Japan's ODA fell by 8.9% in real terms, to $8.9 billion, representing 0.20% of its GNI. While gross disbursements remained relatively steady, there was a substantial increase in repayments of ODA loans.

EU countries increased their ODA in 2003 by 2.2% in real terms, representing 0.35% of their combined GNI. Prior to Monterrey, EU Members committed to increase their ODA by 2006 collectively to 0.39% of GNI, and individually to a minimum of 0.33% of GNI. Features of EU aid included:

- ODA rose substantially in Belgium to 0.61% of its GNI mainly due to Paris Club debt forgiveness operations to the Democratic Republic of Congo; in France to 0.41% of GNI reflecting its debt relief efforts under the HIPC initiative; and in the UK to 0.34% of GNI partly due to contributions to the International Development Association (IDA, the concessional lending window of the World Bank) deferred from 2002.

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- ODA also rose in Germany (3.9% in real terms), Greece (4% in real terms), Ireland (5.1% in real terms) and Luxembourg (5.6% in real terms).

- Small falls in ODA in real terms were registered in Finland (-0.2%), the Netherlands (-1.3%) and Spain (-4.6%).

- Larger falls in ODA in real terms occurred in Austria (-20.7%), Denmark (-12.8%), Italy (-16.7%), Portugal (-24.8%) and Sweden (-14.1%). Austria's ODA fell due to unforeseen factors: early loan repayments and the postponement of bilateral debt forgiveness agreements. Denmark's figure was reduced by exceptional repayments from India, which cleared its ODA debts to small donors, and by lower than expected ODA expenditures outside the core aid programme. The falls in Italy and Portugal were largely due to lower disbursements to multilateral development banks, with Portugal also curtailing its bilateral technical co-operation due to budget constraints. Sweden's aid fell from the 2002 peak caused by a large deposit to IDA to be drawn over several years.

Other DAC countries showed the following changes in real terms in ODA in 2003:

- Australia up 1.9%.

- Canada, down -5.1%, following a repayment from India of about $300 million of its ODA debt stock, and after an exceptional rise of more than 30% in 2002 due to unusually high disbursements for debt relief.

- New Zealand up 9.3%.

- Norway up 4.7%: Norway achieved the highest ODA/GNI ratio in the DAC of 0.92 per cent, making progress towards its goal of 1% by 2005.

- Switzerland up 19.5%, after an exceptional fall in 2002 due to the postponement of a substantial contribution to IDA.

Among the non-DAC donors, Korea's ODA rose in current dollars from $279 million in 2002 to $334 million in 2003.

ODA Outlook for 2006

At the International Conference on Financing for Development donors pledged to increase aid so as to help achieve the Millennium Development Goals (MDGs) and eradicate poverty. Since the conference, a number of DAC members have made further announcements of increases to their development co-operation budgets. The Secretariat estimates that fulfilling these commitments and plans would raise ODA in real terms by a further 26% - about USD 18 billion - between 2003 and 2006, in addition to the 11% real increase already registered since 2001. This would raise the ODA/GNI ratio from 0.25% in 2003 to 0.29% in 2006.

Table 2 shows a simulation of how much additional ODA each member might provide in 2006 compared with 2003 if the commitments, which are subject to budget approval processes, were met.[1] (For countries without a publicly stated commitment, the assumption on which the projection for 2006 is based is stated in column 4 and/or the footnotes.)

[1] This table is updated to use the latest 2003 data as the base year and so replaces the one distributed at the Senior Level Meeting and published in the 2003 *Development Co-operation Report*.

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Table 1. Net Official Development Assistance in 2003

Preliminary data

	2003 ODA US$m current	ODA/GNI %	2002 ODA US$m current	ODA/GNI %	2003 ODA US$m (1) At 2002 prices and exchange rates	Percent change 2002 to 2003 (1)
Australia	**1 237**	**0.25**	989	0.26	1 008	1.9
Austria	**503**	**0.20**	520	0.26	412	-20.7
Belgium	**1 887**	**0.61**	1 072	0.43	1 535	43.2
Canada	**2 209**	**0.26**	2 006	0.28	1 904	-5.1
Denmark	**1 747**	**0.84**	1 643	0.96	1 433	-12.8
Finland	**556**	**0.34**	462	0.35	461	-0.2
France	**7 337**	**0.41**	5 486	0.38	6 030	9.9
Germany	**6 694**	**0.28**	5 324	0.27	5 530	3.9
Greece	**356**	**0.21**	276	0.21	287	4.0
Ireland	**510**	**0.41**	398	0.40	418	5.1
Italy	**2 393**	**0.16**	2 332	0.20	1 943	-16.7
Japan	**8 911**	**0.20**	9 283	0.23	8 459	-8.9
Luxembourg	**189**	**0.80**	147	0.77	155	5.6
Netherlands	**4 059**	**0.81**	3 338	0.81	3 296	-1.3
New Zealand	**169**	**0.23**	122	0.22	133	9.3
Norway	**2 043**	**0.92**	1 696	0.89	1 776	4.7
Portugal	**298**	**0.21**	323	0.27	243	-24.8
Spain	**2 030**	**0.25**	1 712	0.26	1 633	-4.6
Sweden	**2 100**	**0.70**	1 991	0.83	1 710	-14.1
Switzerland	**1 297**	**0.38**	939	0.32	1 122	19.5
United Kingdom	**6 166**	**0.34**	4 924	0.31	5 512	11.9
United States	**15 791**	**0.14**	13 290	0.13	15 541	16.9
TOTAL DAC	**68 483**	**0.25**	58 274	0.23	60 540	3.9
Average Country Effort		**0.41**		0.41		
Memo Items						
EC	8 147		6 561		6 666	1.6
EU countries combined	36 825	0.35	29 949	0.35	30 599	2.2
G7 countries	49 501	0.21	42 646	0.20	44 919	5.3
Non-G7 countries	18 982	0.46	15 627	0.47	15 622	-0.0
Non-DAC Countries:						
Czech Republic	87	0.10	45	0.07	73	61.8
Korea	334	0.06	279	0.06	314	12.5
Slovak Republic	15	0.05	7	0.02	12	74.1

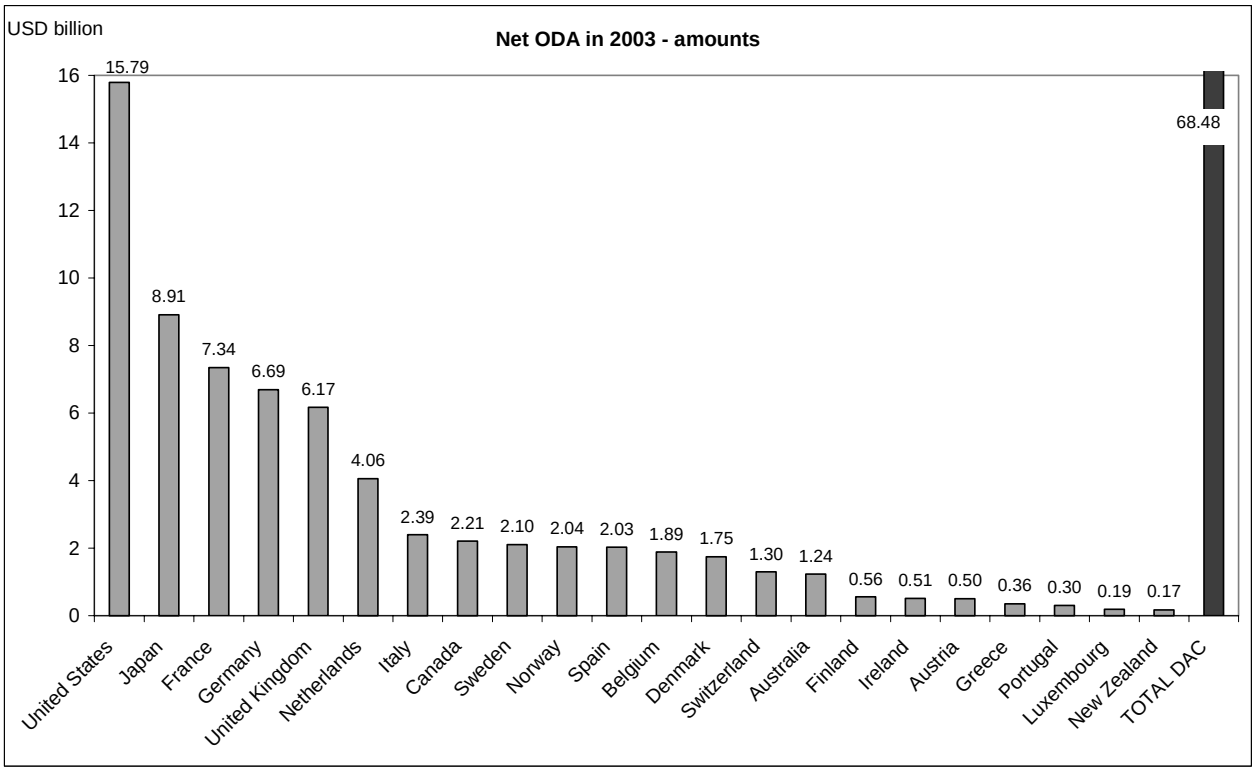
(1) Taking account of both inflation and exchange rate movements.

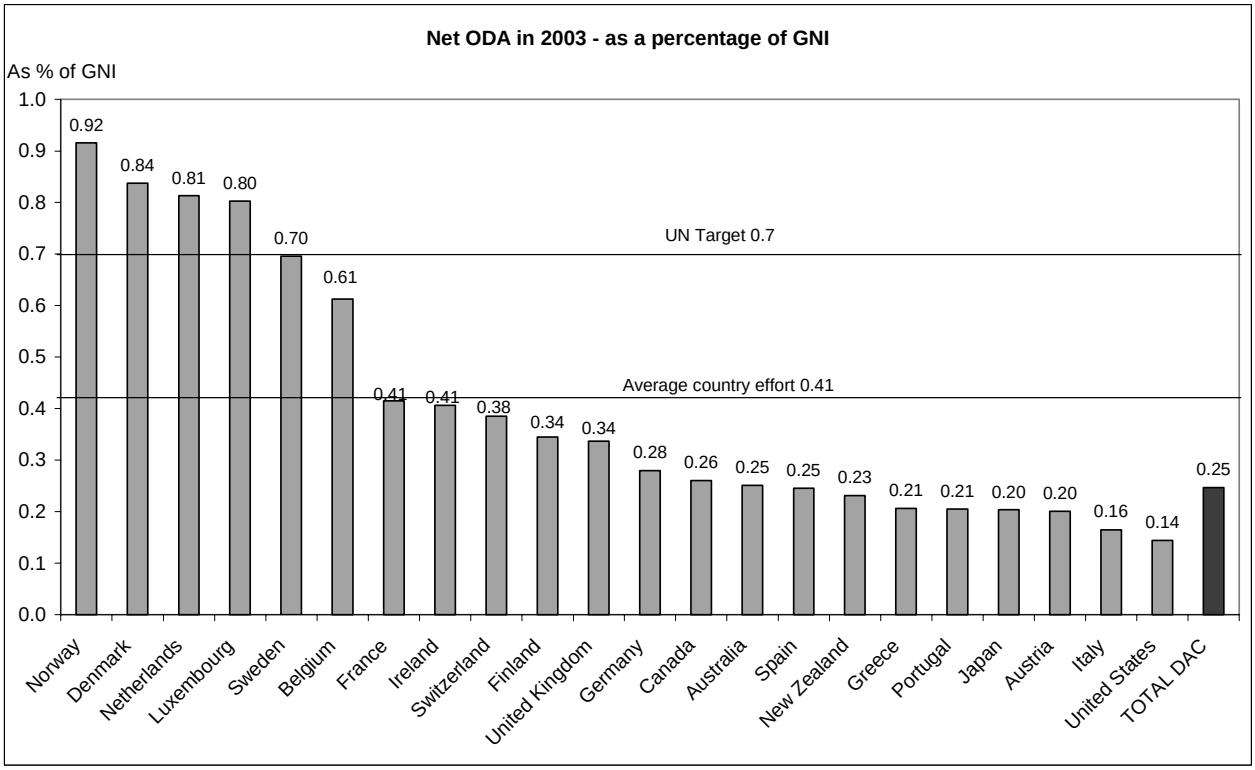
Note: The data for 2003 are preliminary pending detailed final data to be published in December 2004. The data are standardised on a calendar year basis for all donors, and so may differ from fiscal year data available in countries' budget documents.

Source: OECD, 16 April 2004.

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Chart: Net Official Development Assistance in 2003





Source: OECD, 16 April 2004.

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Table 2. Simulation of ODA Prospects for 2006

Country	Net ODA in 2003 (US$ m)	ODA/GNI in 2003	Commitment/ Announcement/ *Assumption*	Year to be attained	Net ODA in 2006 (in millions of 2003 US$)	ODA/GNI in 2006	Real change in ODA in 2006 compared with 2003 (at 2003 prices and exchange rates) [1] (US$ m)	Per cent
Austria	503	0.20%	0.33%	2006	877	0.33%	374	74%
Belgium [2]	1 887	0.61%	0.7%	2010	2 120	0.65%	*233*	*12%*
Denmark	1 747	0.84%	*>0.7%*	n.a.	*1 838*	*0.83%*	*90*	*5%*
Finland [2]	556	0.34%	*0.44%*	2007	708	0.41%	152	27%
France [2]	7 337	0.41%	0.5% (0.7% by 2012)	2007	8 955	0.48%	1 618	22%
Germany	6 694	0.28%	0.33%	2006	8 380	0.33%	1 686	25%
Greece	356	0.21%	0.33%	2006	642	0.33%	285	80%
Ireland [2]	510	0.41%	0.7%	2007	813	0.61%	304	60%
Italy	2 393	0.16%	0.33%	2006	5 092	0.33%	2 699	113%
Luxembourg	189	0.80%	1%	2005	250	1.00%	61	32%
Netherlands	4 059	0.81%	0.8%	Already	4 240	0.80%	181	4%
Portugal	298	0.21%	0.33%	2006	510	0.33%	211	71%
Spain	2 030	0.25%	0.33%	2006	2 899	0.33%	869	43%
Sweden	2 100	0.70%	Long term goal 1% (*at least 0.87% in 2006)*		*2 785*	*0.87%*	*685*	*33%*
United Kingdom	6 166	0.34%	0.4%	2005-06	7 772	0.40%	1 606	26%
EU Members, Total	**36 825**	**0.35%**	**0.39%**	**2006**	**47 880**	**0.43%**	**11 055**	**30%**
Australia [3]	1 237	0.25%	0.25%	Already	1 313	0.25%	76	6%
Canada	2 209	0.26%	8% annual increase	to 2010	2 783	0.30%	574	26%
Japan	8 911	0.20%	*2001-2003 av. level (US$ 9.5bn)*	*in 2006*	*9 500*	*0.22%*	*589*	*7%*
New Zealand	169	0.23%	*Future level is under review*		*202*	*0.26%*	*33*	*19%*
Norway	2 043	0.92%	1%	2005	2 369	1.00%	326	16%
Switzerland [2]	1 297	0.38%	0.4%	2010	1 359	0.38%	62	5%
United States [4]	15 791	0.14%	See footnote 4		20 894	0.17%	5 103	32%
DAC Members, Total	**68 483**	**0.25%**			**86 300**	**0.29%**	**17 817**	**26%**

[1] Assumes average real growth in GNI of 2% p.a. [3% for Canada, 4% for Greece and zero for Japan] from 2003 to 2006.
[2] ODA/GNI ratio for 2006 interpolated between 2003 and year target scheduled to be attained.
[3] As aid volume determined in annual budgets, assumes same ratio in forward years.
[4] Assumes 5% nominal GNI growth and 2% inflation to 2006, and includes estimated $4 billion expenditure from Millennium Challenge Account in 2006.

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Part II

Promoting SMEs for Development: The Enabling Environment and Trade and Investment Capacity Building

Abstract. The ability to integrate in the global economy through trade and investment has an important influence on the rate at which countries grow, according to recent assessments of growth. While globalisation and liberalisation have meant opportunities for SMEs to harness their growth potential and ultimately benefit from poverty reduction, enterprises in developing and transition economies face major challenges in strengthening their human and institutional capacities to take advantage of these new opportunities. This paper looks at the bottlenecks facing these countries and ways for governments, development partners and the private sector itself to address these constraints. It focuses in particular on the specific role of strategy, public-private sector dialogue, support structures and the contribution of women all in the context of achieving the Millennium Development Goals.

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FOREWORD

The following report was prepared as a key background paper for the 2nd OECD Ministerial Conference on SMEs, "Promoting Entrepreneurship and Innovative SMEs in a Global Economy – Towards a more Responsible and Inclusive Globalisation", jointly organised by the OECD and the Turkish Ministry of Industry and Trade and held in Istanbul, Turkey, on 3-5 June 2004.

It sets out policy messages and recommendations that emerged from the preparatory work undertaken in the OECD Working Party for SMEs and Entrepreneurship and validated at the "Regional Workshop on Trade Capacity Building and Private Sector Development" held in Phnom Penh on 2-3 December 2003 and organised jointly by the DAC and Development Centre in co-operation with the Government of Cambodia.

This paper served, in particular, to stimulate debate in Workshop 4 of the Istanbul Conference "Enhancing the Role of SMEs for Development" which addressed four fundamental challenges facing developing and transition country policy makers: i) What are the links between SME development and achieving the Millennium Development Goals (MDGs)? ii) What is specific about SMEs in developing and transition countries? iii) What are the best policies for helping SMEs overcome constraints and benefit from new trade and investment opportunities? iv) What is the role for international partners? The outcome of the discussion on these challenges is further elaborated in Chapter 1.

A focus on the enterprise sector in developing and transition countries, and its capacity to trade and attract investments, has permitted synergies to develop between different strands of work in the OECD Development Cluster and other OECD work:

- Trade Capacity Building, in collaboration with the Development Centre, particularly drawing on two regional workshops organised with stakeholders from the public and private sectors and civil society in Mombasa, Kenya in August 2002 and in Phnom Penh, Cambodia in December 2003.

- The DAC Network on Poverty Reduction (POVNET) in which the private sector's contribution to pro-poor growth is a core theme along with infrastructure and agriculture.

- ODA and investment work carried out in collaboration with the Directorate for Financial and Enterprise Affairs (DAF) to explore ways in which ODA can be used effectively to leverage private investment in developing countries.

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EXECUTIVE SUMMARY

Recent assessments of growth point to an understanding that the rate at which countries grow is substantially determined by i) their **ability** to integrate with the global economy through trade and investment; ii) their **capacity** to maintain sustainable government finances and sound money; and iii) their **ability** to put in place an institutional environment in which contracts can be enforced and property rights can be established.

As globalization proceeds, transition and developing countries and their enterprises face major challenges for strengthening their human and institutional capacities to take advantage of trade and investment opportunities. While governments make policies in trade and investment areas, it is enterprises that trade and invest. Therefore, supply-side bottlenecks in the trade and investment areas and how governments, development partners and the private sector itself address these constraints have direct implications on the economic growth potential of transition and developing countries.

SMEs play a key role in transition and developing countries. These firms typically account for more than 90% of all firms outside the agricultural sector, constitute a major source of employment and generate significant domestic and export earnings. As such, SME development emerges as a key instrument in poverty reduction efforts.

Globalization and trade liberalization have ushered in new opportunities as well as challenges for SMEs. Presently, only a small part of the SME sector is able to identify and exploit these opportunities and deal with the challenges. The majority of SMEs in developing and transition countries, however, has been less able or unable to exploit the benefits of globalization and, to add to the situation, are frequently under pressure on the local or domestic markets from cheaper imports and foreign competition. A major objective of work to promote the development of the SME sector is therefore to change the balance between these two groups of SMEs and to equip SMEs to better meet the challenges of globalization and to benefit from its opportunities.

SMEs, due to their size, are particularly constrained by non-competitive real exchange rates, limited access to finance, cumbersome bureaucratic procedures in setting up, operating and growing a business, poor state of infrastructure and lack of effective institutional structures. The removal of these constraints is a daunting task calling for holistic SME support, *i.e.* an enabling environment for SME development consisting of functioning macro, meso and micro level institutions.

Basic lessons learned in SME development

On the basis of analysis to date, the following lessons seem to hold true, independent of region and level of development among countries:

- SME development requires a crosscutting strategy that touches upon many areas (*e.g.* ability of governments to implement sound macroeconomic policies, capability of stakeholders to develop conducive microeconomic business environments, *inter alia*, through simplified legal and regulatory frameworks, good governance, abundant and accessible finance, suitable infrastructure, supportive education, sufficiently healthy and flexibly skilled labour as well

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as capable public and private institutions, and the ability of SMEs to implement competitive operating practices and business strategies). Thus, SME development strategy must be integrated in the broader national development strategy and/or poverty reduction and growth strategy of transition and developing countries.

- Dialogue and partnerships between the stakeholders (public sector, private sector and civil society) fosters ownership of these strategies, engenders them more implementable (by better addressing SME needs), making them politically credible, and sustainable.

- Access and integration into local, national, and global markets require substantial investments in sustainable institutional and physical infrastructure development and service delivery to SMEs in all areas, including those that are rural and/or remote. Continued dialogue and partnerships between stakeholders into implementation and review of supportive measures, particularly, those related to capacity building in executing institutions, yields improved outcomes.

- Enhancing women's ability to participate in SME development should be taken into account at every level, as women account for an important share of private sector activity and contribute most to poverty reduction. Gender dimensions need to be mainstreamed throughout SME development strategies and programs, with additional specific, targeted initiatives directed at critical roadblocks.

Building up trade and investment capacity of SMEs

SMEs must be able to respond quickly and efficiently to international market signals to take advantage of trade and investment opportunities and reap the benefits of the international trading system. This means they need to be competitive and productive. Effective business support systems are needed to enhance competitiveness and productivity of SMEs.

Development of an effective business support system is also a key condition for the success of both trade and investment capacity building. It requires business support agencies (including financial institutions), which are customer-oriented and which have a demonstrated capability of penetrating the SME sector. Specific recommendations include:

- Take steps to increase the capacity of financial institutions to construct profitable SME lending programmes, while prioritizing the development of innovative solutions to collateral issues, such as the acceptance of more flexible forms of collateral, particularly for SMEs with few fixed assets; the use of group guarantees and loan guarantee schemes for SMEs; more emphasis on cash flow than balance sheets in assessment of borrowing capacity; easy and effective loan application assessment methodologies.

- Take steps to strengthen the business support system, through an intermediary role, by building capacities in business services, both public and private (*e.g.* market, product and process information provision, accounting, market analyses and research, legal advice, transportation, express delivery, advertising).

- Develop a national strategy for export development and promotion, led by the appropriate Ministry, but which involves participation by all key stakeholders. The overall objective should be to increase the volume and value of exports and the number of exporting companies. The strategy should seek to address the needs of firms at different stages of

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export market development. It should also seek to integrate export support and promotion into a well developed and effective business support system.

- Set up a single export promotion agency, which could be combined with a Foreign Direct Investment (FDI) function. Based on good practice in mature market economies, the establishment of such an agency should separate policy making from policy implementation. The agency should:
  - Operate in a commercially oriented manner.
  - Be result rather than procedure oriented.
  - Be staffed by people with relevant, practical business experience.
  - Seek to be customer-oriented.
  - Include private sector representation on its Management Board.
  - Be funded commensurate with its objectives.
- Develop export support, which includes:
  - The provision of information about specific markets and potential customers.
  - Help in making contact with potential customers or appropriate public and private intermediaries and business service providers.
  - Assistance with market visits.
- Develop an SME-FDI linkage 'offer', based on the 'fit-to-supply' principle and, which includes the following elements:
  - Improving the flow of information about potential local suppliers to potential Multi-National Corporation (MNC) purchasers and about supply opportunities to potential suppliers through the development of a national Website and/or business directories, supplemented by 'meet-the-buyer' events.
  - Targeting suppliers on the basis of proven abilities and commitment to future improvements.
  - Working closely with MNCs by inviting them to help potential suppliers to a) understand their supply requirements b) identify areas in which they have good opportunities to supply and c) draw attention to weaknesses they must overcome in order to succeed. Such an intermediary role helps to build mutual understanding and trust between MNC and potential supplier.
  - Helping SMEs/suppliers identify needs and then to access the public and private support services they need.

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  - Offering some form of monetary incentive to MNCs and local SMEs to participate in the linkage programme. This could include contributing to the salary costs of engineers & managers in MNCs who devoted time to supplier upgrading (Singapore); cash grants to promising suppliers to help with initial investment costs (Ireland); and subsidized training and consultancy necessary for enhancing supplier capability (Chinese Taipei).

  - Developing capacity building programmes that include supply chain and cluster initiatives, which recognize the potential for developing tiers of suppliers to maximize trickle down effects, including to micro enterprises as lower tier suppliers.

- Setting up industrial parks, and when viable, business incubators in order to provide an appropriate infrastructure for SME suppliers, launch cluster development initiatives, where possible, through public/private partnerships.

Improving policy coherence and aid effectiveness

Policy coherence and a joined-up government on the transition and developing country side are essential for the successful implementation of SME development strategies. Development partners need also to understand that trade and investment capacity building has to go hand in hand with market access and that improved coordination among donors, better attention to local conditions and further capacity building on their side are building blocks to success, if the world is going to adopt new approaches and invent new ways of working together to foster competitiveness of SMEs in transition and developing countries.

Box 1. Key Policy Recommendations

- Embed strategies toward the private sector and SMEs in countries' broader national development and poverty reduction programmes. Encourage and help SME associations to participate effectively in national dialogues that help set the strategic frameworks for development, so that the contribution and the policy and support needs of SMEs are fully recognised as central to growth, employment and poverty reduction.

- Strengthen SME capacities to improve their competitiveness in domestic, regional and global markets. Encourage and support private sector associations and enterprises able to provide information on markets and standards, advice on strategies, and access to technology and innovation coupled with appropriate financing packages. Promote tools, such as value chain analysis, which enable entrepreneurs to see what problems and challenges they need to address within and beyond their own borders and what kind of partners they need to help them.

- Promote policy coherence at regional, national and international level. Work to support whole of government approaches so that trade and investment policies and standard setting are aligned with development co-operation objectives and policies. Support completion of the Doha Round of multilateral trade negotiations, including a reduction of barriers to trade in manufacturing and agricultural sectors with major benefits and opportunities for developing countries.

- Maximise the spillover of management skills and knowledge from multi-national enterprises to local SMEs. Spillovers of knowledge and management skills to local firms are one of most critical benefits of foreign direct investment for host countries. Support policy frameworks and multi-national enterprise behaviour that facilitate such spillovers and better document real-world cases to increase public understanding of the contribution of foreign direct investment in progression of development.

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CHAPTER 1

CHARACTERISTICS AND IMPORTANCE OF SMES

Introduction

There is worldwide consensus that high rates of economic growth contribute to economic and social development and poverty reduction. At the same time, there is growing recognition that poverty reducing growth depends on the quality of growth: its composition, distribution and sustainability.[1]

Recent scholarly assessments of growth converge on the view that "the rate at which countries grow is substantially determined by i) their ability to integrate with the global economy through trade and investment; ii) their capacity to maintain sustainable government finances and sound money; and iii) their ability to put in place an institutional environment in which contracts can be enforced and property rights can be established".[2]

As globalization proceeds, transition and developing countries and their enterprises face major challenges in strengthening their human and institutional capacities to take advantage of trade and investment opportunities. This has become a top priority on the global development agenda and features prominently in the final statements of key international meetings over the past few years, including the Doha Declaration and the Monterrey Consensus.

While governments make policies, including in trade and investment areas, it is enterprises that trade and invest. In market economies, the enterprise sector is predominantly private and spans through the whole spectrum of economic activity in agriculture, manufacturing and services, including trade, and increasingly also infrastructure and social services. Within the private sector, there are different types of market players: the self-employed, micro, small, medium and large enterprises and multinational companies.

Private small and medium-sized enterprises (SMEs) typically account for more than 95% of all firms outside the primary agriculture sector, constitute a major source of employment and generate significant domestic and export earnings in the OECD, transition and developing countries.[3] Improved SME competitiveness could obviously contribute to economic and social development and poverty reduction.

This background report will look at how to enhance SME competitiveness in developing and transition economies in a globalizing world, with a particular focus on what governments,

1. See, for example, World Bank (2000), CIDA (2003), DFID (2001), Sida (2003a) and UNDP (2003).

2. Lawrence Summers (2003): Note how Mr. Summers, the President of Harvard University, emphasizes "abilities" and "capabilities" to get certain growth outcomes accomplished rather than advocating specific policies. Rodrik (2003) argues that these "abilities" and "capacities" do not map neatly into the standard policy preferences, and can be generated in a variety of ways, p. 6.

3. See OECD (2002), APEC (2000), FUNDES (2002).

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development partners (OECD governments and others), and SMEs need to do to: i) build local SMEs' capacities to trade and take up expanding regional and international trade opportunities, and ii) strengthen SMEs' linkages with foreign investors and thus enhance FDI benefits to the local economy.

In this chapter the characteristics and contribution of SMEs to development is briefly reviewed. Chapter 2 emphasizes the need to embed the SME development strategy into national frameworks and links the constraints SMEs face in legal, regulatory and administrative environments, access to finance, the institutional support structure, infrastructure and human resource development to good practice recommendations. In Chapter 3, specific measures for enhancing SME exporting and FDI-SME linkages are discussed together with a brief discussion on improving aid effectiveness. The paper concludes by setting out the main components of an SME strategy and provides policy recommendations.

Outcomes from the Istanbul Conference

This paper served, in particular, to stimulate debate in Workshop 4 of the Istanbul Conference "Enhancing the Role of SMEs for Development" which addressed four fundamental challenges facing developing and transition country policy makers: i) What are the links between SME development and achieving the Millennium Development Goals (MDGs)? ii) What is specific about SMEs in developing and transition countries? iii) What are the best policies for helping SMEs overcome constraints and benefit from new trade and investment opportunities? iv) What is the role for international partners? The section below reflects the outcomes of that discussion.

MDGs and the SME sector: Reaching the MDGs will not be possible without a viable and vibrant private sector in developing countries, thus the importance of attention to the SME sector

- The MDGs need growth driven by the private sector and the private sector means the SME sector in many developing countries.

- Growth has different poverty reduction impacts. A focus on the SME sector will help to deliver pro-poor growth via employment and income generation as well as a contribution to government revenue.

- SMEs help to tackle poverty at source. A distinctive feature of SMEs in developing countries is that they are located where poor people are, they employ poor people and they produce for poor people.

- SMEs can contribute to the expansion of the middle-class and the establishment of business advocacy associations that represent a more diverse range of business interests.

What is specific about SMEs in developing and transition countries?

SMEs play a particularly important role in developing and transition countries. They constitute a major source of employment and generate significant revenues and export earnings. While they face similar challenges as SMEs world-wide, developing countries' SMEs are particularly constrained by weak human and institutional capacities and are slow to reap the full range of benefits of globalisation. These specific challenges include:

- Limited voice in policy making and lack of institutionalised public/private sector dialogue.

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- Anti-private sector bias and mistrust between the public and private sectors.

- Lack of adequate property rights and enforcement which affects access to credit, especially for women.

- Lack of information (market, standards, barriers to entry and exit, barriers to access) adequate statistics, and support institutions.

- Higher proportion of publicly owned businesses and a predominant public sector role in export and investment promotion.

- High percentage of micro enterprises/large informal sector and cumbersome regulations/lack of incentives that discourage entry into the formal sector.

What are the best policies for helping SMEs in developing and transition economies?

Strategy and dialogue

- Evidence points to a recurrent number of obstacles – but solutions are context specific.

- There is a need for policy makers and private sector representatives to design a coherent SME strategy, in the context of the national development strategies that prioritises bottlenecks and gaps and is informed by diagnostics and statistics.

- Private sector and SME development strategies must be embedded in the broader national development/poverty reduction strategies, so as to ensure coherent and sustainable approaches to growth and poverty reduction.

- The private sector must be involved with government and civil society in designing strategies. Dialogue is critical to build trust and reinforce consensus around a shared vision of policy goals and instruments.

- SMEs, formal and informal ones, are not in the same privileged position as well organised large industries in having direct access and influence on policies. Government must acknowledge the need for a dialogue with SMEs. The latter need to move from being 'passive observers' to 'active partners'. SME associations can provide the platform for such an inclusive dialogue and make government policies more responsive to the needs of the private sector.

Investment climate and enabling environment

- Business needs a stable macroeconomic policy setting and an enabling environment which fosters entrepreneurship, innovation and competitiveness. In developing and transition countries in particular, government must strengthen the rule of law, cut down on bureaucracy, remove gender bias, invest in infrastructure, fight corruption, etc.

- Creating an enterprise culture, centred on innovation and evaluation, is a key step. Identifying and sharing of international best practices would make a valuable contribution towards this goal.

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- Governments are doing all of the above … but they need to do it more, better and in a more transparent and sustainable manner. But, by itself, this won't be enough.

Support polices

- Experience shows that successful SMEs need not only an enabling environment but also functioning business support structures. Business support agencies must be business-like, customer-oriented, staffed with competent and trusted personnel and able to constantly adapt to the evolving private sector needs.

- For SMEs to be innovative and competitive, business support services should provide assistance in basic business areas (e.g. accounting, management, information and communications technologies (ICT), but also on market analysis and research, product development and upgrading, compliance with standards, quality assurance and certification.

- Clustering, as well as linking up to foreign investors, can help SMEs overcome their weaknesses, generate economies of agglomeration and better integrate into global supply chains. Exposure to and sharing of best practices will generate positive spillovers in terms of management skills and knowledge to local firms.

- Over time, the private sector itself should increase its stake in and become the main provider of these services.

What is the role for international partners?

- Donors need to place SME development at the centre of the strategy to meet the MDGs and donors actively support investment and enterprise development. But it is not clear whether these efforts tackle the bottlenecks identified by the private sector, or whether they are sufficiently co-ordinated to be effective. Donors need a more strategic approach to SMEs, encourage private sector involvement in policy design and implementation, scale up their support and align it to nationally defined private sector development strategies.

- OECD countries can help in sharing best practices and strengthening capacities (institutional set up, strategy design and evaluation, policy dialogue), but also in creating an international environment that is conducive to development, through efforts to strengthen policy coherence.

- International partners have a stake in successfully completing the Doha Round of multilateral trade negotiations, which would provide a major boost to economic activity and open up opportunities for SMEs.

The definition of SMEs

Small and medium-sized enterprises (SMEs) are a very heterogeneous group. SMEs are found in a wide array of business activities, ranging from the single artisan producing agricultural implements for the village market, the coffee shop at the corner, the internet café in a small town to a small sophisticated engineering or software firm selling in overseas markets and a medium-sized automotive parts manufacturer selling to multinational automakers in the domestic and foreign markets. The owners may or may not be poor; the firms operate in very different markets (urban, rural, local, national, regional and international); embody different levels of skills, capital, sophistication and growth orientation, and may be in the formal or the informal economy.

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Statistical definition of SMEs varies by country[4] and is usually based on the number of employees, and value of sales and/or value of assets. Due to its ease of collection, the most commonly used variable is the number of employees. The EU and a large number of OECD,[5] transition and developing countries set the upper limit of number of employees in the SMEs between 200-250, with a few exceptions such as Japan (300 employees) and the USA (500 employees).

At the lower end of the SME sector, a large number of countries define a group, which is a mixture of the self-employed and "micro" enterprises, with less than 10 employees. Irrespective of the level of development of an economy, a significant proportion of micro and, sometimes, small enterprises are found in the informal sector or the shadow economy. Schneider (2003)[6] compared the size of the informal sector in 22 transition (former Soviet Union and Central and Eastern Europe) and 21 OECD economies from 2000-2002 and found that the size of the informal sector amounted to an average of 16.7%, 29.2% and 44.8% of GDP in OECD, Central and Eastern Europe and the former Soviet Union economies, respectively.

Contribution of SMEs to development and the new challenges

The notion of SME and entrepreneurship development was introduced into the growth and development landscape as early as the late 1940s with the introduction of targeted policies (grants, subsidized credits, special tax treatment, etc.) and the establishment of small business or SME support agencies by governments (*e.g.* publicly funded SME agencies were set up in 1948 in Japan, 1953 in USA, 1954 in India, 1966 in Tanzania, 1976 in Turkey).

Despite a long history of development efforts, SMEs, including the informal sector, were perceived rather as a synthetic construction mainly of "social and political" importance,[7] especially throughout the 1980s and up to late 1990s. Although domestic SMEs and the informal sector constituted most of what could be and what are still deemed as "the" private business activity in most developing countries, private sector development strategies advocated for and implemented in these countries were skewed towards the needs of large-scale business, including foreign invested ones. This type of policy advice was partly motivated by the rather disappointing[8] results achieved through extensive SME support systems operated in developed countries since the 1970s.

Recent empirical studies show that SMEs contribute to over 55% of GDP and over 65% of total employment in high-income countries, Figure 1. SMEs and informal enterprises, Figure 2, account for over 60% of GDP and over 70% of total employment in low-income countries, while they contribute over 95% of total employment and about 70% of GDP in middle-income countries. Figures 1 and 2 also show that the relative importance of SMEs and the informal sector (shadow economy) are inversely associated with economic development. In low-income countries, especially in the least developed economies, the contribution of SMEs to employment and Gross Domestic Product (GDP) is less than that of the informal sector, where the great majority of the poorest of the poor make a subsistence level of living. Therefore, an important policy priority in developing countries is to reform

4. Ayyagari, Beck and Demirgüc-Kunt (2003) also provide official SME definitions for 74 OECD, transition and developing countries, including references to the sources of data.

5. OECD (2002), p. 4.

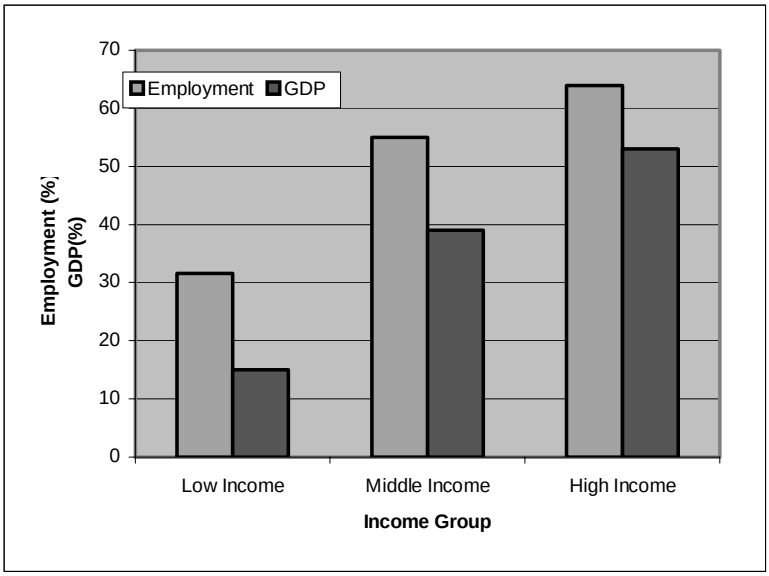
6. Schneider (2003).

7. Halberg (2001), p 5.

8. See for instance Meyer-Stamer, Jörg and Frank Waltering (2000).

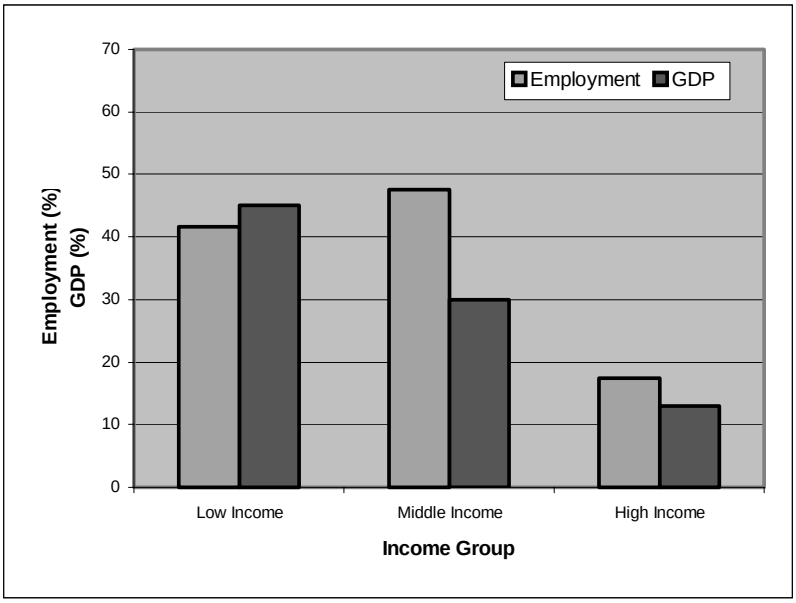
the policies that divide the informal and formal sectors, so as to enable the poor to participate in markets and to engage in higher value added business activities.

Figure 1. SME Sector's Contribution to Employment and GDP (Median Values)



Source: Ayyagari, Beck and Demirgüc-Kunt (2003), pp. 27-28.

Figure 2. Informal Sector's Contribution to Employment and GDP



Source : Ayyagari, Beck and Demirgüc-Kunt (2003), p. 27-28.

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In middle-income countries, formal SMEs contribute about 20% more to employment and GDP than the informal enterprises. Thus, in these countries, eliminating factors that discourage informal enterprises from entering the formal SME sector would also bring about gains in economic terms. This is evidenced by the fact that SMEs contribute over 3 times as much as the informal sector in both total employment (~65%) and GDP (~55%) in high-income countries, and that these countries are also taking initiative to bring as many informal enterprises as possible into the formal sector.

SMEs are an important source of export revenues in some developing countries. Table 1 provides information on the SME shares of manufactured exports in selected East Asia and African developing economies and OECD countries. An interesting observation is that SMEs contribute a larger share of manufactured exports in more industrialized East Asian economies (56% in Taiwan, more than 40% in China) and in India (31.5%) than the less industrialized African economies (<1% in Tanzania and Malawi). Table 1 also seems to support the intuitive understanding that medium-sized enterprises have higher export potential than small enterprises with up to 50 employees (see SME definitions in Tanzania, Malawi and Mauritius in comparison to those in other developing and OECD countries). These observations show that policies for the promotion of SME export potential and SME exports must be targeted.

SMEs contribute to employment and income generation and export revenues. However, in order to tap into the potential of SMEs for development and poverty reduction, transition and developing country governments, development partners and SMEs themselves need to address a number of challenges:

- The domestic SME/private sector has to expand, through:
  - The creation of new and innovative firms.
  - The graduation of as many informal enterprises as possible into the formal sector.
- SMEs have to become more competitive and productive at their home base.
- At least a proportion of these nationally competitive SMEs have to achieve a level of competitiveness that will enable them to integrate into the global value chains through trade (exports and internationalization) and investment, including linkages with FDI.

Dealing with these challenges is becoming even more complex and demanding as globalization proceeds. On the one hand, globalization has the potential to open up access to new markets, technologies, skills and capital for SMEs. On the other hand, further economic integration brings with it a striking increase in competition from imports, the entry of new foreign investors and the strengthening of domestic, large firms that start to take over traditional, mostly local SME markets.

Challenges are multi-dimensional. As trade barriers, transport and communication costs fall, SMEs are required to add more value to their products to stay ahead and compete with lower cost rivals. Consumer demand is changing rapidly as incomes rise and choices increase when imported products become easily available in domestic markets. Technological advances create new products and transform almost every stage of business from production to marketing, sourcing and logistics. New rules introduced through the multilateral trade system and foreign buyers require SMEs to comply with higher technical (*e.g.* technical barriers to trade), environmental (*e.g.* ISO14000) and labour standards in domestic and export markets. Multinational enterprises seeking out new markets and investments offer capable SMEs the opportunity to insert themselves into global value chains through subcontracting linkages, while those that are unable to do so increasingly face the danger of

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losing their existing markets. Competition within the developing world for export markets, foreign investment and resources is also intensifying. Against this backdrop of increased global competition, SMEs, SME associations, support institutions and governments in transition and developing countries have to adjust and adopt new approaches and invent new ways of working together to foster SME competitiveness.

Table 1. SME Shares of Manufactured Exports in Developing and OECD Countries

Country	Year	Definition of an SME (a)	% SME manufacture exports
Developing Countries			
Chinese Taipei	Early 1990s	<100 employees	56
China	Early 1990s	<100 employees	40-60
Korea	1995	<300 employees	42.4
Vietnam	Early 1990s	<200 employees	20
India	1991/1992	<Rs 30 M investment in plant & machinery	31.5
Singapore	Early 1990s	<100 employees	16
Malaysia	Early 1990s	<75 employees	15
Indonesia	Early 1990s	<100 employees	11
Thailand	Early 1990s	<100 employees	10
Mauritius	1997	<50 employees	2.2
Tanzania	2002	<50 employees	<1.0
Malawi	2003	<50 employees	<1.0
OECD			
Denmark	Early 1990s	<500 employees	46
France	1994	<500 employees	28.6
Sweden	Early 1990s	<200 employees	24.1
Finland	1991	<500 employees	23.3
Japan	1991	<300 employees	13.3
USA	1994	<500 employees	11
Average for 6 OECD countries			24.4

Note: (a) Definition adopted by each study, which may be different to the official national definition of an SME.

Studies: Korea (Kim and Nugent, 1999), India (Badrinath and Others, 1997), Mauritius (Wignaraja and O'Neil, 1999), Tanzania and Malawi (estimates based on Wignaraja's fieldwork), the remaining countries (OECD, 1997).

Source: Wignaraja, Ganesh (2003).

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CHAPTER 2

STRENGTHENING SME COMPETITIVENESS IN TRANSITION AND DEVELOPING COUNTRIES

Metcalf, Ramlogan and Uyarra (2003) argue that competitiveness is embodied in the characteristics of the firm; namely:

- The current efficiency and effectiveness of the use of resource.
- The willingness and the ability to relate profitability to growth of capacity (*i.e.* the willingness to invest).
- The ability to innovate to improve technology and organization and thus improve efficiency and effectiveness.

The authors state that competitive advantage, which must be measured in relation to rivals in markets, is determined by how efficient and effective the prevailing markets for products, labour and capital are. They further add that entrepreneurship; the introduction of new productive combinations and innovation is the driving force that continually creates new competitive advantages and opportunities for profit and growth.

Meyer-Stamer (1995) concurs with the view that competitiveness is created at the firm level, but that it is partly derived from a systemic context and emerges from complex patterns of interactions between government, enterprises and other actors, and will therefore exhibit different forms in each society.

SME development strategies will necessarily be country and context specific. Each country will have its own challenges, opportunities and priorities for change. Resources available for implementation will vary by country, so that results achieved will also be different. For example, in the 1980s and most of the 1990s, enterprise policy in European countries focused on employment creation, and initiatives supporting new business creation were prominent. Then, emphasis changed to one of achieving international competitiveness and programs encouraging business growth, support for technology based businesses and creation of an enterprise culture within the society started to gain in importance.

Notwithstanding such specificity, past and present experiences and practices of developed countries and scholarly assessments of results accomplished are of value and offer a menu of lessons and best practices for transition and developing countries. The responsibility rests with the transition and developing countries to make their choices based on sound assessments of their own context. OECD and other development partners can assist developing countries by building capacities in conducting such assessments, and when they make the choices, by providing capacity building assistance towards implementation.

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To date, the following SME development lessons seem to hold true, independent of region and level of development among countries:

- *Peace and stability is a key requirement* for the development of SMEs and for attracting foreign investment. Studies show that war and crime are main deterrents of private investment, in particular for foreign investors.

- *SME development requires a crosscutting strategy*, (*i.e.* its success depends on the *ability* of governments to implement sound macroeconomic policies, the *capability* of stakeholders to develop conducive microeconomic business environments, and the *ability* of SMEs to implement competitive operating practices and business strategies). Good policies come in clusters. Thus, SME development strategy must be integrated into the broader national development strategy and/or poverty reduction and growth[9] strategy of transition and developing countries.

- *Dialogue and partnerships between the stakeholders is essential* (public sector, private sector and civil society). Dialogue and partnership foster ownership of SME strategies, engenders them more implementable (by better addressing SME needs), politically more credible, and more sustainable.

- *Investments in physical infrastructure and business services and the implementation* capacity of policy makers, local level administrators and support structures determine success. Access and integration of SMEs into local, national, regional and global markets require substantial investments in sustainable physical infrastructure development and business service delivery to SMEs in all areas, including those that are rural and/or remote. Continued dialogue and partnerships between stakeholders into implementation and review of supportive measures, particularly, those related to capacity building in institutions at all levels, yields improved outcomes.

- *Enhancing women's ability to participate in SME development* should be taken into account at every stage and level, as women account for an important share of private sector activity and contribute most to poverty reduction. Gender dimensions need to be mainstreamed throughout SME development strategies and programs, with additional specific, targeted initiatives directed at critical roadblocks.

A cross-cutting SME strategy embedded in the national development framework

SMEs cut across sectors. Improving SME competitiveness requires policies that act on the economic, political and social institutions within the country, on the resulting markets and on the organizations that regulate, stabilize and legitimize these markets. As such, an SME development strategy has to bring to the forefront the challenges that SMEs face due to size effects and address the deficiencies in institutional and organizational structures, with a view to enhance SME competitiveness. First, taking a bird's-eye-view of how the macroeconomic policies and the microeconomic environment (the business environment) affect an SME, the prime decision-maker to invest in growth and competitive advantage is justified.

9. The recent trend is to the include 'growth' as a goal into the poverty reduction strategies. See for example, Vietnam's Comprehensive Poverty Reduction and Growth Strategy (CPRGS), approved by government in May 2002, for prominent poverty reducing role accorded to SMEs, the reforms underway and needed to promote SMEs for development.

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Sound macroeconomic policies

Predictability of the business environment is a crucial factor determining business decisions. Not only SMEs, but also large firms, including foreign invested ones, depend on the ability of government to implement sound and consistent macroeconomic policies. Low budget deficits, low inflation, and a stable and transparent currency regime, yielding competitive exchange rates in an economy, help secure the minimum stability that businesses needs to make sound business decisions. Shiffer and Weder (2001) confirmed through a worldwide survey[10] that inflation affected SME growth more than larger enterprises and that exchange rates also affected SMEs more, due to lower hedging opportunities available to smaller firms, but that policy instability affected all firms equally (see Table 2). At the macro level, policy makers have to be aware of these size biases, if SME competitiveness is to be improved.

Microeconomic environments conducive to business

Improving the capability of stakeholders to create microeconomic environments conducive to business is a many-pronged endeavour. In an ideal case, a microeconomic environment conducive to business (an enabling business environment) may be characterized by, *inter alia*, simplified legal and regulatory frameworks, good governance, absence of corruption, plentiful and accessible finance, suitable infrastructure, an abundance of flexibly skilled and healthy labour force, an appreciation of enterprise among the society at large, access to non-labour inputs at competitive prices, etc. Simply said, it is where SMEs interact with the institutions, markets and organizations to gain competitiveness. A multitude of stakeholders, each having different levels of capabilities, operate in and interact with each other in this environment.

Table 2. Ranking: Percentage of firms that considered the obstacle to be major

Rank	All Firms		Small Firms		Medium Firms		Large Firms	
1	Financing	36.5	Financing	38.9	Financing	38.0	Policy instability	29.8
2	Inflation	34.6	Inflation	36.9	Taxes and regulation	37.2	Financing	27.9
3	Policy instability	34.4	Taxes and regulation	35.5	Inflation	36.1	Inflation	26.2
4	Taxes and regulation	33.5	Policy instability	35.0	Policy instability	36.0	Street crime	23.9
5	Exchange rate	28.0	Street crime	30.6	Exchange rate	29.7	Corruption	23.4
6	Corruption	27.7	Corruption	30.1	Corruption	27.4	Exchange rate	22.4
7	Street crime	27.2	Exchange rate	28.9	Street crime	25.5	Organized crime	21.7
8	Organized crime	24.5	Organized crime	26.9	Organized crime	23.4	Taxes and regulation	21.4
9	Anti-competitive practices	21.9	Anti-competitive practices	23.8	Anti-competitive practices	21.9	Infrastructure	18.2
10	Infrastructure	17.0	Infrastructure	16.3	Infrastructure	17.2	Anti-competitive practices	16.9
11	Judiciary	13.7	Judiciary	13.8	Judiciary	14.4	Judiciary	11.6

Note: (a) Major means that firms chose 4, the highest possible obstacle level. Lower obstacle levels are: 3, moderate obstacle; 2, minor obstacle; and 1, no obstacle.

Source: Shiffer and Weder (2001).

10. Survey covered 80 countries and the territory of West Bank and Gaza and collected information from 10 090 firms.

Shiffer and Weder (2001) clearly show that there are size-based policy biases against SMEs, and more so against smaller firms in the microeconomic environment. These biases cover all areas: legal and regulatory frameworks, governance issues, such as bureaucracy and corruption, access to finance and property rights. Interventions on all fronts are required. The existence of such biases point out to either market or government failure and is closely related to the capacity of the stakeholders involved. At times, markets may correct these failures. However, in some cases, removal of failures in the business environment may require adopting structuralist (selective intervention)[11] approaches rather than market-friendly approaches, as market forces may not be sufficient to remedy the capacity deficits in the system. The choices made will be political, but they should be based on sound analyses.

Competitive SME business practices and strategies

It is up to the SMEs to implement competitive business operating practices and business strategies. However, the options available to SMEs are also closely related to the quality of institutions, markets and organizations that constitute the business environment. It is the efficiency and effectiveness of institutions, markets and organizations that encourage or discourage SMEs to take their cues for learning new ways of doing business, compare their own competitive characteristics with those of their rivals, and make their decisions to invest, including the introduction of innovations into their business strategies. If the environment is weak, SMEs' ability to detect market signals that would enable them to invest and grow will also be weakened.

Presently, transition and developing countries seem to have a plethora of policies and strategies that relate to the private sector in one way or another: private sector development strategy, SME development strategy, trade and investment policies and strategies, export strategy, and so on. Yet, the responsibility for implementing these various national policies/strategies and programmes are disbursed throughout the public sector institutions, where both capacities and authority to coordinate are weak. Furthermore, there is need to establish dialogue and partnerships between the government, SMEs, the civil society and the academia to appropriately assess and prioritize SME challenges and to implement remedial actions. Governments usually consult with the private sector, though mostly with large and foreign investors, when setting policies since public/private dialogue enhances ease of implementation, political credibility and sustainability strategies. However, there are also capacity deficiencies that must be overcome on the side of SME membership organizations as discussants.

As illustrated above it is necessary to ensure that there is concerted and coordinated action at all levels to improve the competitiveness of SMEs. This can be achieved by embedding the SME development strategy into the national development strategy, so that effects of relevant policies on SMEs are seriously considered at every stage and level (a joined-up government, strengthened private sector organizations), appropriate interventions for correcting market and government failures are prioritized and capacity building interventions for SME stakeholders are implemented. The title of the SME development policy of United Kingdom, *Think Small First, 2001,* reflects very well the government's attempt in mainstreaming SME issues into national development frameworks (see Box 2).

11. Lall (2001) argues that developing countries in which market failure is particularly diverse and widespread may require coordinated strategies to move their economies from low-skilled, low technology activities to higher valued activities and proposes a structuralist (selective intervention) rather than a market-friendly approach to overcome impediments to development.

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Box 2. SME Policy Priorities-United Kingdom

Think Small First, 2001

Priority Areas

In order to meet the challenges of the next few years the Government aims to focus on three priority areas:

1. The prevailing culture and environment, including macro-economic stability and the policy environment.
2. The regulatory framework for business.
3. Support for business at each stage of the business life cycle, including people, skills, advice, workshop, IT, finance and international trade.

Source : www.sbs.org.uk.

It must also be clear that inserting an arbitrary notion of "SME" into the national development framework or into an existing private sector development strategy would not be sufficient. Anti-SME biases must be assessed in detail within the context of the country: as to the legal, regulatory frameworks and administrative practices, in access to finance, in respect of entrepreneurial support structures and infrastructure, and with a genuine concern for effective use of human and natural resources.

Enabling legal, regulatory and administrative environments

The legal and regulatory frameworks establish the "rules of the game" in a society and govern the way in which the government, enterprises and civil society interact with each other. The rules influence investment decisions, the opportunities and rewards available to economic actors. Governments set these rules to raise tax revenues for investments in public goods, among others, defence, protection of law and order, and to maintain health and safety of consumers, and the environment. Compliance with the rules comes with costs of doing business. Some examples of legislation that affect the private sector, including SMEs are listed in Box 3.

Bannock, Gamser, Juhlin and McCann (2002) argue that when imposed at unrealistic levels and inadequately enforced, regulation divides the economy into formal and informal sectors and erects barriers between the two, which perpetuates the division. The passive acceptance by governments in transition and developing countries that regulation cannot be fully enforced in the informal sector is a recognition of the fact that the level of regulation is too high and too costly to be applied to all forms of economic activity: *i.e.* if enforced they would deprive a large proportion of the population from earning a living.

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Box 3. Examples of Legislation Relevant for SMEs/private sector

- Company, commercial and contract laws
- Property laws, including property rights
- Taxation laws
- Accountancy law
- Bankruptcy law
- Laws concerning compensation for damage
- Laws concerning consumer safeguards,
- Laws concerning environmental protection
- Labour laws, minimum wage laws, working safety laws
- Rental laws
- Laws of association
- Credit legislation, banking and financial market laws
- Stock exchange law
- Insurance laws
- Intellectual property rights law
- Laws concerning competition, including anti-trust laws

An SME "friendly" legal, regulatory and administrative environment would be characterized, among others, as one where:

1. Property rights are clearly recognized.
2. Contracts are easily enforced.
3. A simple, transparent and low-compliance-cost tax system is operational and it is perceived as fair.
4. Businesses are able to register with authorities through a simple and inexpensive system, preferably by remote access through the Internet.
5. Business licensing requirements are minimized, and when they are enforced, the objective is to safeguard health and safety of consumers and labour rather than being a source of revenue for local and/or central government.
6. Labour regulations are balanced and flexible, protecting the rights of labour and the firm equally.
7. SMEs, whether they are exporting or importing, interact with a streamlined customs administration that is efficient, simple and transparent.
8. Financial sector regulations (banking, insurance, leasing) recognize SME constraints and have introduced appropriate legal and regulatory instruments that enable commonly available SME assets to be used as collateral.
9. Public administrators at local levels appreciate entrepreneurs as contributors to economic growth, treat them fairly and are committed to limiting corruption to a minimum.
10. Legislation and regulation is gender insensitive, rule of law and rules of the game apply equally to men and women.
11. SMEs can easily set up and join membership organizations.
12. Bankruptcy legislation does not impose unduly high penalties on the entrepreneur or the SME.

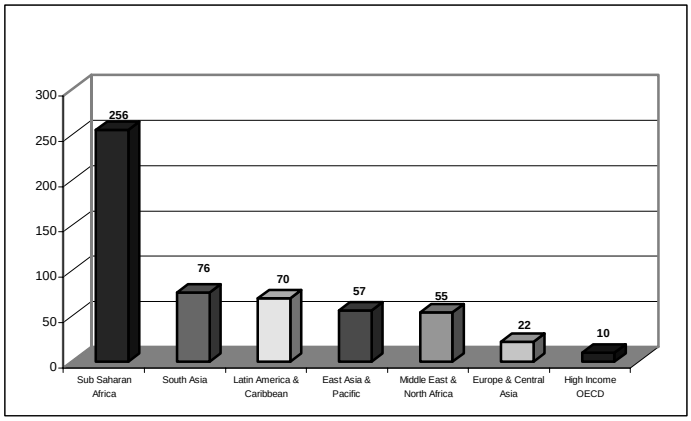
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While recent studies[12] make a strong case regarding the role of efficient and effective market institutions on economic development compared to global integration and geography, other studies[13] support the insight that getting all of these institutions to function according to the ideal case is a great challenge. In fact, these studies show that in the industrialized countries, most of these institutions evolved to their present state over a period of more than two to three centuries, and that they were not present when the now industrialized economies were at the initial stages of industrialization. Moreover, industrialized economies of the present are still exerting great effort to adjust their institutions to the global trends, investing tremendous amounts. Obviously, institutions rule economic development. However, in the scope and space of this paper, we will only suffice to discuss a selected number of institutions with the aim of demonstrating their effect on SME development.

The World Bank's *Doing Business* database provides indicators of the cost of doing business in 133 economies, as of March 2004: it identifies specific regulations that enhance or constrain investment, productivity, and growth. Indicators are built on studies of prevailing regulations and cost estimates collected in the field directly from firms (small, independent, limited liability firms employing 5-50 employees), and interviews with organizations charged with administering institutions. The database differs from existing reports[14] on the effects of the business environment on firms, in that; previous studies tend to rely on business perceptions surveys and analyst assessments.

Figure 3 shows that an entrepreneur in a Sub-Saharan Africa economy incurs registration costs amounting to 2.5 times that of GNI per capita, in cash, while the same start up in a high income country would need to spend only 10% of GNI per capita. While the same costs vary from 22% to 76% in transition and developing countries in the other regions of the world, they are still prohibitively high and discourage firms from setting up and formalizing.

Figure 3. Cost of Starting a Domestic SME (% of GNI per capita)



Source: http://rru.worldbank.org/doingbusiness.

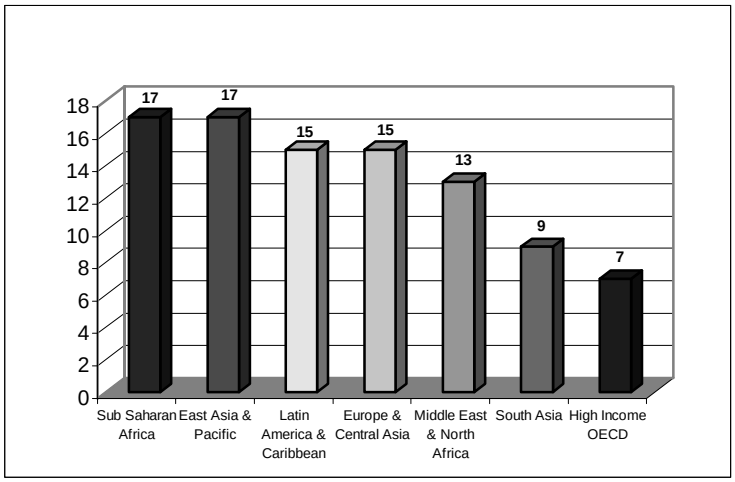
12. See Rodrik, Subramanian, Trebbi (2002) and Acemoglu (2003).

13. See Chang (2001) and Bannock, Gamser, Juhlin and McCann (2002).

14. See, for example, Fries, Lysenko, Polanec (2003) for an analysis of EBRD Business Environment and Enterprise Performance Survey 2002.

Figure 4 shows that entrepreneurs in East Asia and Pacific would forego 17% of their estate when exiting, while the same cost would be 7% in high-income countries. It is also interesting to note that there is not much of a difference among developing countries with respect to exit costs. Market exit costs also influence the to-be-entrepreneur's decisions of entry: the higher the cost of exiting, the more difficult will be the decision to invest.[15]

Figure 4. Cost of Closing a Domestic SME (% of estate)



Source: http://rru.worldbank.org/doingbusiness.

If one of the objectives for SME development is to expand the formal SME sector, including innovative small firms, legal and regulatory costs of business have to be rationalized. A case in point is the recent amendment of company law in Vietnam. The new Enterprise Law came into effect as of 1st January 2000. In the following two years, more than 26,000 new enterprises registered for business. Nearly 70% of these entities were new businesses, and the rest constituted of informal household enterprises that entered the formal SME sector.[16]

The informal sector/the shadow economy does not only consist of the self-employed and the micro enterprises. Businesses that formally exist also tend to conduct at least some of their operations informally, as the costs of doing business increase. There are a large number of empirical studies,[17] which show that there will be observable; annual increases (decreases) in the size of the shadow economy as the tax and social security contribution burdens and the intensity of regulation increase (decrease) within an economy.

Costs of compliance with business regulation cannot be quantified only by the cost of official fees and tariffs that come with the procedures. There are also costs incurred in time, the business lost

15. Ability of an economy to adjust to rapid change through easy entry and exit from business, sometimes qualified as "creative destruction" has been shown to increase overall productivity, thereby enhancing growth potential.

16. UNDP (2002), p. 40.

17. Schneider (2003), Djankov, Lieberman, Mukherjee and Nenova (2003), Schneider and Enste (2000), Johnson, Kaufmann and Zoido-Lobaton (1998a, 1998b), Johnson, Kaufmann and Schleifer (1997) among others.

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when dealing with regulation and unofficial fees paid due to corrupt bureaucratic practices. Governments may adopt "good regulation" principles to decrease such costs. Good regulation is defined by its proportionality, transparency, accountability and consistency (see Box 4). There are roles both for the government and the private sector, if good regulation principles for SMEs are to take root.

Box 4. Principles of Good Regulation for SMEs

Proportionality

- The impact of regulation on small business is identified, establishing an appropriate balance between risk and cost
- Needless demands are not placed on regulated small business

Transparency

- Policy objectives, including the need for regulation, are clearly defined and effectively communicated to those involved
- Those being regulated understand their obligations and know what to expect from the enforcing authorities

Accountability

- Proposals are published and all those effected are consulted before decisions are taken

Consistency

- New regulations are consistent with existing regulations
- Regulations are applied consistently across the country

Source: Conclusions from the Cambodia Workshop: "Trade Capacity and Private Sector Development in Asia", Regional workshop, 2-3 December 2003, Phnom Penh, Cambodia.

On the side of the government, there must be high-level political commitment to change the way bureaucracy functions: *i.e.* clear identification of regulatory objectives, assessments of cost on SMEs of new regulation, communication of regulatory proposals to the SMEs for consultations, and clear instructions on how to comply with it, and, as required, capacity building in the civil service administering regulation. SMEs, on the other hand, would need to take initiative to become informed and qualified discussants with the civil service through their membership organizations, make a genuine effort to understand regulation, and to comply with it, once it is issued after the consultative process. These processes are used in a number of OECD countries, where governments conduct Regulatory Impact Assessments (RIAs, *e.g.* in UK and Ireland), and Small Business Impact Assessments. In a number of other OECD countries there are acts that aim to simplify the forms filled and the steps to be completed (*e.g.* USA), share information collected on firms, so that SMEs do not have to provide it many times to different government agencies (*e.g.* Sweden) and have tax information declared on-line (*e.g.* Italy).

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Women entrepreneurship contributes to income generation and poverty reduction significantly in least developed economies,[18] and in most developed economies such as USA and Canada, growth in the numbers of women owned businesses is out-pacing those owned by men.[19] Yet, one of the key deficiencies in legal, regulatory and administrative frameworks is gender bias against women's participation in economic activities. Many of these biases are based on tradition and socio-cultural contexts: rights to inheritance, rights to own land, right to set up business in own name may legally be denied to women. In other cases, while such rights are in the legislation, in practice, they are not exercised. While keeping a whole half of a country's population out of the formal economy should not be acceptable by any standards, more needs to be done to encourage implementation, where such rights are legally recognized. Similar to good regulation principles, legislation and regulation should be systematically assessed for gender balance and the civil service should be sensitized to gender biases through regular assessments.

Creation of enabling legal and regulatory frameworks and administrative practices has to go hand in with the intentional promotion of an appreciation of enterprise and the entrepreneur by the civil service. In most transition and some developing countries, the overhang from the era of planned economies still persists, where perceptions about entrepreneurs are skewed towards the negative. Moreover, low pay levels of civil servants and increasing demands on them through downsizing under public administration reform programs in transition and developing countries continue to encourage rent-seeking behaviour. Finally, for improved frameworks for SMEs to become the norm, members of the civil service would have to develop an appreciation of the contribution SMEs make to "economic" development in the country. Considering the fact that an appreciation of SMEs' economic contributions have been slow to emerge at the international level, and that reforms are both very costly, and require high-levels of commitment over extended periods of time (*i.e.* political stability is a pre-condition), it is likely that it will be some time before transition and developing countries will catch up with OECD countries in this respect. OECD and other development partners can expedite this process by offering assistance to developing countries not mainly for drafting appropriate frameworks, but also extending assistance for capacity building at administering these improved frameworks. In fact, it must also be noted that legislation and regulation that is not enforced is worse than having no regulation at all.

Access to finance

SMEs identify financing, especially medium to long-term finance, as their topmost obstacle to growth and investment. These obstacles come at two levels. In least developed economies, and in some transition and developing economies deficiencies in both the macroeconomic and microeconomic environments pose challenges: high budget deficits and unstable exchange rates and legal, regulatory and administrative environment poses major obstacles to access of SMEs to financing. In some economies, capital may just not be available,[20] property rights regimes may not allow ownership of land, markets for transfer of immovable assets may be very underdeveloped, credit and collateral legislation may not allow certain assets that SMEs commonly have access to, to be used as collateral (*e.g.* future acquired property), absence of registries for mortgages and pledges may increase risks to lenders, contract enforcement and asset liquidation may be hampered due to weaknesses in legislation and in the judiciary.

18. See Ulusay de Groot (2000) and (2001).

19. See OECD (2000).

20. Compare US$ 100 million available as government sponsored equity for technology-based SMEs in India in 1999 with US$ 5 billion available of the same in Germany per annum, Dossani and Kennedy (2002), p. 24.

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The second level of obstacles may be due to organizational capacity weaknesses: For example, in least developed economies, business services markets in accounting, auditing, financial management and legal counsel may be so underdeveloped that SMEs may not be able to access or afford such services: essential services they would need when they approach banks and other types of lenders.

In more advanced developing countries, where there is reasonable progress in the fundamental institutions, SMEs may still face challenges in accessing formal finance in the form of bank loans, guarantees, venture capital, leasing and so on. For instance, although SMEs are by far the largest group of customers of commercial banks in any economy, loans extended to SMEs are often limited to very short periods, thereby ruling out financing of any sizable investments. Moreover, due to high-perceived risks in SME loans, access to competitive interest rates may also very limited. Finally, in many developing economies, banks prefer to lend to governments, which offer less risk and higher returns, crowding out most of the private sector from the financial system.

In industrialized countries there has been a long tradition of providing subsidized loans and grants to all types of SMEs to enhance their competitiveness. A more recent trend in OECD economies is a focus on exporting and technology-based SMEs, generally removing subsidies from asset and operating capital financing and shifting to subsidies for promoting exports and technology upgrading, providing loan and exchange rate guarantees, and providing grants for quality improvement.[21] Some governments in the developing world have also introduced specialized banks for SMEs (*e.g.* in India, Small Industries Development Bank of India, in Turkey, the Halkbank) to the same effect. However, size of programs in the developing world is usually much smaller.

Innovations introduced by commercial banks in OECD economies have obtained good results in servicing SMEs. However, the infrastructure and capacity building needed to implement these innovations have yet to reach most developing countries (see Box 5).

Box 5. Challenges in Access to Finance and Recent Financial Innovations

SME Constraints in Access to Finance	Banks' Response to Access Constraints
· SMEs are regarded by creditors and investors as high-risk borrowers due to insufficient assets and low capitalization, vulnerability to market fluctuations and high mortality rates. · Information asymmetry arising from SMEs' lack of accounting records, inadequate financial statements or business plans makes it difficult for creditors and investors to assess the creditworthiness of potential SME proposals. · High administrative/transaction costs of lending or investing small amounts do not make SME financing a profitable business. *Source:* UNCTAD (2001).	· Reducing information asymmetry of SMEs and high perceived risks by using credit scoring systems, external information providers, risk self-assessment for the SME entrepreneurs, pricing to the level of risk; sharing risk with third parties (loan guarantees) using covenants as an alternative to loan guarantees, and setting up special support units for high risk customers such as start-ups. · Reducing costs of lending by applying latest information technologies; streamlining the organization and simplifying the lending process. · Developing products better adapted to SME needs. · Improving financial services for SMEs through training of bank staff and the segmentation of SME customers. · Cooperating with SME organizations and other business development providers in order to reduce risks and costs and combine financial with non-financial services.

21. See, for example, UNCTAD (2001) and Dossani and Kennedy (2002).

In addition to loan financing, SMEs have the option to cooperate with venture capital investors. Venture capital involves the provision of investment finance to SMEs in the form of equity or quasi-equity instruments not traded on recognized stock exchanges. It is long-term risk finance where the primary return to the investor is derived from capital gains rather than dividend income. Venture capital investors are actively involved in the management of the firms they invest in, to assure the success of the venture. Venture capital investors actively seek SMEs in high growth sectors (see Box 6).

Box 6. Precisioair (Venture Capital Funds in Africa)

Name: Precision Air Services Ltd. (Precisionair)

Description: Private airline in the United Republic of Tanzania

Established: 1993

Jobs created: 145

Owners: Founder Michael N. Shirima, local venture capital funds

Financing: Raised more than USD 733,000 in critical early-stage venture capital through the Africa Project Development Facility.

Precisionair, the first privately owned commercial airline in the United Republic of Tanzania, is an example of how finance is essential for an SME to grow.

Starting small: The founder of Precisionair, Mr. Shirima is a model of entrepreneurship in Africa. He started his small business in 1987 with only two planes, aerial sprayers serving large farms. A few years later, a severe drought in Tanzania forced him to change to another field: passenger service, and he identified tourists as the prime target. For this new venture, Shirima required new airplanes but he did not have all the capital needed. However, he continued his plans and opened Precision Air Services Ltd. in 1993.

Recent trade and investment liberalization contributed to a significant development of tourism in the United Republic of Tanzania, a country with spectacular wildlife and natural wonders. However, many of the key sites were far from the main international arrival points. Thus, Shirima's aim was to provide tourists with a suitable means of transport, to easily reach popular destinations.

Raising funds: Shirima, a former executive at the "defunct" East African Airways, knew that for building Tanzania's first privately owned airline would require substantial outside capital. Therefore, he approached the Africa Project Development Facility (APDF), which after a thorough feasibility study confirmed the viability of the project and found potential investors. Thus, Precisionair could raise USD 333,000 in equity financing from the Tanzania Venture Capital Fund (TVCF). This financing, used for acquiring new airplanes, was critical for building the enterprise. Since then, the company has expanded considerably. In 1996, Precisionair approached the APDF again in order to replace the airplanes with larger and faster airplanes. This time it was able to raise USD 400,000 from the East African Development Bank. Today, Precisionair has seven aircrafts that can transport 176 passengers each.

Impact: Precisionair has contributed remarkably to Tanzania's recent tourism boom through its regular scheduled air services that enables tourists to reach key attractions. Moreover, the company provides affordable and reliable domestic transport for the local business community.

Source: SME FACTS, www.ifc.org, January 2001.

Other significant forms of SME financing include leasing,[22] trade credit, and fiscal incentives in the form of tax breaks. In developing countries leasing and trade credit systems require the existence of appropriate legal and regulatory frameworks: while a legal basis for leasing needs to be present,

22. See, for instance, www.orix-pak.com for information on leasing operations of Japanese firm Orix in Pakistan.

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enforcement of contracts have to be ensured for both leasing and trade credit mechanisms to work well. Developing economy governments sometimes set up fiscal incentive schemes for SMEs, however, cumbersome procedures of tax authorities may render incentive schemes inaccessible or too costly.

In developing countries there are a large number of microfinance schemes targeting the self-employed and micro enterprises. These schemes usually provide small amounts of working capital and a majority caters to traders and very small agriculturalists (see Box 7). Micro scale, rural based, women entrepreneurs are among primary target groups. Women's lack of access to land renders them as non-customers of formal financial institutions in most of least developed countries. Furthermore, gender-biased attitudes prevailing among bank staff, who are mainly men, low level of education and training among women entrepreneurs and lack of access to information about sources of financing are also major barriers for women entrepreneurs.[23]

Box 7. KUPEDES: Indonesia's Model Small Credit Program

By 1983, years of heavy losses and fiscal cuts had made the vast network of village banks belonging to the state-owned Bank Rakyat Indonesia unsustainable. Shutting the banks down risked serious unemployment and the loss of an important credit delivery mechanism. The government responded by taking a novel approach. It established a new, market-based rural small credit program, the Kredit Umum Pedesan (KUPEDES), aimed at transforming village banks into self-sustaining full-service financial units. The program's principal goals were to provide credit to small borrowers at market rates and to mobilize rural savings. By the time the World Bank's USD 102 million loan to KUPEDES was approved in 1987, the program was already working with a profit. By loan completion in 1992, the program's assets had grown 21 times over the 1984 level. The village banks were reaching 5 per cent of the country's households with loans and 15 per cent with deposit services.

A recent World Bank audit draws two major lessons from the KUPEDES experience. First, it is possible to create a micro-lending program that serves the poor and is profitable and self-sustaining. But to succeed the bank units will need to lend at market rates, use their income to finance their operations, and devise appropriate savings instruments to attract depositors. Second, developing a savings instrument for the poor is at least as important as providing them with loans. In Indonesia, SIMPEDES, the village savings program, attracted thousands of depositors. And by mobilizing rural savings, it not only provided the banks with a stable source of funds, it also kept financial savings in rural areas, thus helping continue development in the countryside.

Finally, the audit highlights the main reasons for village banks' success: simplicity of loan design, which enabled the banks to keep costs down; effective management at the unit level backed by close supervision and monitoring by the centre; and appropriate staff training and performance incentives. By themselves, however, these factors would not have been enough for the program to succeed. The presence of an existing institutional network of village banks and a thriving economy that had spread to many rural areas were also critical.

Source: Precis No. 104, Operations Evaluation Department, World Bank, January 1996, www.worldbank.org/oed.

Access to finance is essential for improving SME competitiveness, as SMEs have to invest in new technologies, skills and innovation. Access to finance issues cannot be resolved by implementing financing schemes or programs in a vacuum. There are institutional issues covering a spectrum from the macro level to the micro, which are accompanied by capacity deficiencies. A wide spectrum such as this may only be tackled by mainstreaming SME development in national frameworks. It is also

23. Ulusay de Groot (2001).

noteworthy to add that effort to resolve access to finance issues is not solely the responsibility of governments. SMEs need to take a better initiative than pointing it out as their number one obstacle: they need to mobilize joint advocacy and recommendations, based on sound analyses, through their membership organizations. Most significantly, SMEs must implement sound business practices and continuously invest in good internal management systems: in accounting, planning, financial, operations and human resource management.

Strengthened institutional support structures

The SME development strategy has to be inclusive and build on a consensus on SME challenges, goal and broad policy direction among key SME stakeholders. The strategy has to concert and coordinate efforts of institutional structures that make or affect policy (the parliament, provincial councils and political parties), the administrators of policy (line ministries, local government authorities and regulatory structures), and public support organizations (SME, export, investment, regional development, public sector education and training institutions and financial institutions).[24] The private sector's roles and responsibilities have to integrate into the strategy through business membership organizations, organizations of business development service (BDS) and private financial service providers, trade unions and civil society organizations (see Box 8).

Public/private dialogue structures

Clearly, the multi-dimensional and multi-stakeholder nature of SME competitiveness strategies require on-going consultations between the public and private sectors, hence, institutionalized public/private dialogue mechanisms have emerged. In developed and developing countries, these institutionalized mechanisms are either lead by (*e.g.* in Thailand, the prime minister chairs the SME Development Council) or report to (in the UK to the prime minister, in the Philippines to the Congress and the president) the highest level in government. While some public/private dialogue structures may bring representatives from both sectors together, other structures primarily represent the private sector, including SMEs, which then conducts formal, regular dialogue with high-level representatives in the government. When the structure is not specifically focusing on SMEs, interests of large, domestic and foreign invested businesses take their place on the agenda more prominently. An example of private sector based dialogue structure has been operational in Mauritius since 1970 (see Box 9).

SME/private sector membership structures

There are capacity deficiencies on both sides of the public/private sector dialogue structures. In the past, many poor countries and regions hardly considered the private sector as a real partner in SME development processes. While, top-down, control oriented attitudes by governments reduced the scope for private sector participation in policy formulation and implementation, non-constructive criticisms of governments by the private sector worked to strengthen confrontational attitudes and mutual mistrust. This situation is rapidly changing, for instance, in South and Southeast Asia, as demonstrated by the emerging public/private dialogue in agribusiness and garment sectors.[25]

24. White and Chacaltana (2002), p. 19-21.

25. OECD (2003), see also, www.oecd.org/dev/cambodia.

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Box 8. Institutional Structures SMEs Interact With

Central Level	Local Level
Parliament and political parties	Provincial Councils
Line Ministries	Provincial Equivalent or Branches of Central Ministries
Judiciary	Courts
Regulatory Authorities · Tax · Customs · Business Registration & Licensing · National Standards Organization	Local Branches of Regulatory Authorities · Tax · Customs · Business Registration & Licensing · Branches of National Standards Organization
Education and Training Institutions · University · Technical and Vocational Schools	Education and Training Institutions · University · Technical and Vocational Schools · Vocational Centres, Adult Education Centres
Apex Business Membership Organizations · General · Sectoral · Professional	· Business Membership Organizations · General · Sectoral · Professional
Financial Service Providers · Banks · Microfinance Institutions · Leasing Companies · Insurance Companies	Financial Service Providers · Banks · Microfinance Institutions · Leasing Companies · Insurance Companies
Business Development Service Providers · Public Organisations-Central – SME Promotion – Export Promotion – Investment Promotion · Apex Organizations of Private BDS Providers	Business Development Service Providers · Public Organisations-Local Centres/Branches – SME Promotion – Export Promotion – Investment Promotion · Private Sector BDS Providers
Apex Trade Union Organizations	Local Trade Unions
Civil Society Organisations	Local, Community Based Organisations

Box 9. Public Private Dialogue- Mauritius' Joint Economic Council

In Mauritius, the Joint Economic Council (JEC), established in 1970, operates as the coordinating body of the nine major multi-sectoral institutions and industry associations in Mauritius (Chamber of Commerce; Chamber of Agriculture; Employers' Federation; Sugar Producers' Association; Export Processing Zone Association; Bankers' Association; Insurers' Association; Hotels and Restaurants Association).

The JEC is managed by a Council of 18 associates (2 per member), a Chairman who rotates every two years and a full-time Director. The structure and functioning of JEC enable an enhanced coordination amongst the different institutions while permitting to build an institutional expertise for each represented industry. Hence, sectoral issues are dealt with the relevant industry association, while crosscutting issues such as national budget, wage negotiations, international trade negotiations are dealt with all the JEC members. The dialogue takes place in a structured manner as well as on an ad hoc basis. The JEC is fully funded by its members.

Consultations with the private sector

Formal

1. Government/JEC meetings: chaired by the prime minister and attended by senior ministers; held usually twice a year; on broad economic policies.
2. Tripartite wage negotiations
3. Private sector proposals for the National Budget: with Minister of Finance; once a year.
4. Representation in a number of joint Government/Private Sector committees: *e.g.* the National Negotiating Committee on Post-Lomé discussions; the WTO Standing Committee (the private sector was represented in all the WTO Ministerial Conferences); the Regional Cooperation Council.

Informal

1. Regular meetings between the relevant private sector organizations and relevant Ministries on sectoral issues
2. Joint promotional activities (conducted by the Government abroad).
3. *Ad hoc* Committees

Source: Laporte, Geert (2003); www.jec-mauritius.org.

Business membership organizations, specifically those that are industry-based, are the channels through which the SME/private sector voices its needs and concerns to the government and lobby for its support, facilitate networking and partnerships between members (firms) and with similar institutions abroad and provide a number of other services to members.

Despite their important role in facilitating SME/private sector participation in policy making and development processes, business membership organizations in developing countries have problems related to representation of SMEs, capacity and funding. Despite their numbers in the economy, and also within the membership of associations, smaller firms do not seem to have the requisite weight and voice in these structures.

Due to lack of funding, business membership organizations usually operate without qualified and professional management staff and are unable to benefit from specialist inputs and research, upon which they should base their advocacy efforts. Lack of funding and "free riding" problems also constrain these structures in developing and delivering appropriate information, facilitation, and networking services to their membership. Their weaknesses work in almost a vicious circle eroding

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the expectations of members, in turn, resulting in further funding, representation and capacity problems.

Lack of effective mechanisms for structured public/private dialogue further reduces the motivation of SME/private sector stakeholders, including membership bodies, in investing in and learning to help themselves. There is growing consensus that public/private dialogue can help to a) improve the ownership and quality of policy making in general and in SME development in particular, b) consolidate the democratic legitimacy of governments, c) foster conducive policy environments and increase national cohesion, d) provide an instrument for interest mediation, and e) improve service provisioning. Therefore, business membership organizations should seek and support opportunities to act as partners in structured, public/private dialogue, and governments and development partners should place capacity-building programmes for these structures on their agenda.

Policy coordination and monitoring structures

Backstopping the work of institutionalized public/private dialogue institutions as well as policies and programmes resulting from these, are strong, independent or semi-autonomous, central level SME policy coordination and monitoring institutions (*e.g.* in the UK, Small Business Service, in the USA, the Small Business Administration, in the Philippines, the Bureau of Small and Medium Business Development and in Thailand, the SME Office), see Annex I for schematic depictions of a selected number of SME institutional support structures.

Paradigm shift in SME support

There has been a gradual and global shift in the paradigm on how SMEs should be supported through institutional structures. Initial efforts, which date back to the early 1950s worldwide, perceived the SME sector through paternalistic lenses and identified it as *an entity to be protected*. Lessons learned, and advances especially, in biotechnology, information, communication and materials technologies and efforts to liberalize, shifted the paradigm to one of *SME promotion*, starting in the 1980s. The result was an enhanced focus on specific sub-sectors and activities; with considerably larger amounts of assistance and subsidies going to high technology oriented manufacturing and service firms and entrepreneurship development. With the advent of globalization and trade liberalization, the paradigm shifted again, and is now, one of *facilitation, where a holistic approach to competitiveness takes priority*. In the developing world, India was a leader in SME development, with extensive support structures dating back to 1954 and the Indian experience vividly illustrates how the institutional support to SMEs evolved as the paradigm shifted.[26]

Accordingly, other important functions of these structures are to compile statistics on the state and health of the SME sector in collaboration with national statistics bodies, to conduct or commission research on various SME issues, to coordinate and monitor regulatory reforms affecting SME competitiveness and the implementation of "good regulation" principles, to develop guidelines on SME promotion program design, implementation and monitoring for national stakeholders, including those at the local level, to facilitate SME support programs by providing financial and technical assistance to local stakeholders, including business membership organizations, to coordinate SME related interventions of line ministries and regulatory agencies, to implement/coordinate programs to improve appreciation of the enterprise and the entrepreneurs among the civil service, including at local levels to act as an information clearing house for SME programs and policy progress within the country and to coordinate development partner assistance. Evidently, the functions listed may be

26. Jain, Pankaj (2003) and www.smallindustryindia.com

considered those of an *"SME advocate"* within the public sector for an enabling environment and one of a "*facilitator"* for SME promotion.[27]

In a large number of developing countries the paradigm shift has yet to occur or is experiencing difficulties in progressing: There may not be a SME development strategy; or the government and development partners may have agreed that a private sector development strategy would suffice to address SME development issues as well. Among some of the other reasons may be the following:

- The existing SME development strategy may be one of public sector SME promotion only, *i.e.* design and public sector delivery of business development services (BDS) through a national SME agency and its branches at the provincial level, with large numbers of civil servants aiming to act as consultants to SMEs, albeit without significant results – such SME agencies were mostly set up with extensive development partner assistance throughout the 1980s and 1990s. Experience shows that it is difficult to reform these SME agencies.

- A re-worked SME development strategy may have a more holistic approach, involving measures for creating an enabling environment, public/private dialogue and BDS facilitation. However, existing structures may be resisting change, may be politically entrenched, and hard budget constraints may be disabling governments to conduct major reorganization of existing structures.

- While the partner government may be willing to adopt a facilitator's role and to reorganize existing structures, development partners may be reluctant to get involved in a "public" sector SME institutional assistance program, based on previous unsatisfactory experiences in the country or elsewhere. This is a situation that allows existing inefficient institutional structures intact, continuing to cause a drain on the budget and not so much to show for it.

- Development partners, having been disillusioned with the public sector SME support structures in the past, may have opted to support only private sector structures such as business membership organizations, microfinance institutions, commercial banks, non-governmental organizations (NGOs) and civil society organization (CBOs). This approach is also not very productive, since it neglects the other side of the equation, the need to build up capacity in the public sector.

Achieving policy coherence

It is the government that has the responsibility to implement a strategy for improving SME competitiveness. And the need is to have policy coherence through a "joined-up government", collaborating closely with the SME/private sector, the civil society and the development partners. Without a lean, but capable policy coordination and monitoring structure at the national level, this is difficult to achieve. Policy coherence may be built up by building up the capacity of the public sector and SME membership organizations in conducting SME policy analysis based on hard facts, mechanisms for information sharing and coordination among multiple types and levels of SME stakeholders within the public sector, including development partners, and capacity for monitoring and evaluation of progress made as policies are implemented.

27. Here, promotion is used to mean support programs and schemes, such as a "technology upgrading program", "a membership organization capacity building project", etc.

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In least developed countries, the poverty reduction strategy (PRS) or the national development framework presents an opportunity for achieving policy coherence. However, growth policies, and hence SME development policies, have yet to be integrated into the PRS, except in a few cases such as Vietnam. Likewise, at a more operational level, development partners, in collaboration with the World Bank, support capacity building of governments in developing and using the "Medium Term Expenditure Framework"(MTEF) as a planning, coordinating and monitoring instrument. In some countries, SME development issues have started to come up as elements of the MTEF; however, without the institutional capacity (a lean, national level SME development policy coordination and monitoring unit) and funding (for facilitation of measures) required, SME issues cropping up are fragmented at best.

Business development services (BDS) for SMEs

SMEs must be able to respond quickly and efficiently to market signals to take advantage of trade and investment opportunities and reap the benefits of the international trading system.[28] Among others, business development services (BDS) help SMEs to learn implement competitive business practices and strategies. The Committee of Donor Agencies for Small Business Development define BDS to include training, consultancy and advisory services, marketing assistance, information, technology development and transfer, and business linkage promotion (see Box 10). Disillusionment with the public provision of BDS has led to a market-based approach: traditional programs have been supply driven, they have crowded out potential private sector BDS suppliers with free or subsidized services, they have been limited in outreach, and of low-quality due to limited institutional capabilities (*e.g.* civil service based SME consultants without business experience).

Box 10. Scope of Business Development Services (BDS)

Business development services include training, consultancy and advisory services, marketing assistance, information, technology development and transfer, and business linkage promotion. A distinction is sometimes made between "operational" and "strategic" business services. Operational services are those needed for day-to-day operations, such as information and communications, management of accounts and tax records, and compliance with labour laws and other regulations. Strategic services, on the other hand, are used by the enterprise to address medium- and long-term issues in order to improve the performance of the enterprise, its access to markets, and its ability to compete. For example, strategic services can help the enterprise to identify and service markets, design products, set up facilities, and seek financing. The market for operational services may already exist, since there is often articulated demand and willingness to pay for these services. In contrast, markets for strategic services for SMEs have largely failed to develop, and they are the focus of most donor interventions in BDS.

Source: World Bank (2001), p. 1.

The Donor Committee has articulated the ultimate vision for BDS as one of a well-functioning market with a diverse array of high quality services that meet the needs of a large proportion of SMEs affordably. The approach does not totally discharge the public sector, including the development partners, of their duties, but rather limits their interventions to developing private sector BDS markets as "*financiers*" of BDS facilitators (may be private or public) and BDS providers (may be private or public). One of main operational features of the new BDS market-development approach is sub-sector and BDS market analyses, through which SME needs, potential demand for particular BDS and the state of the BDS market are assessed. Accordingly, the new BDS approach seeks to develop efficient and effective commercial BDS services that are more relevant and of higher quality. The approach approves both supply and demand side interventions, as required. The BDS market development

28. USAID (2003), p. 9.

approach also implies some general characteristics for BDS, BDS providers and BDS facilitators (see Box 11).

A number of development partners have started to use the new approach and some interesting results are emerging. For example, a recent BDS market survey[29] conducted in a region of Tanzania indicated that micro and small enterprises (MSE) perceived "training in book-keeping (69.2%), financial services (64.8%), marketing and sales promotion (62.9%), training in costing and pricing (54.9%), transport services (49.5%), and training in new product technologies (49.2%) as the most needed competitiveness improving services for their business. While the surveyed MSEs that acquired any of these services did not have any problem with paying for these services, the survey also revealed that there were a very small number of public or private suppliers of these services in the region.

BDS is one of the areas in which development partners have been most active in their support of developing and transition economies. This trend has to continue due to the important contributions BDS makes to building up human capital in SMEs and to facilitating sound business decisions and good business practices.

Box 11. Business Development Services (BDS) providers and facilitators

Demand-driven

- Customer has to pay, at least partially, for BDS, so that demand could be objectively verified;
- Public institutions that provide BDS should take in private sector members to their executive boards or set up private sector based advisory bodies, etc.

Differentiated and customized BDS, using tools such as:

- Sub-sector approaches.
- Professional market research findings on the amount and nature of demand.
- Value/supply chain methodologies.
- Cluster and network development.

Delivered in a business-like manner

- BDS providers, even if they are in the public sector should be managed according to business principles and not administered.
- Private service design and delivery is preferred, but public sector subsidies may be used to facilitate new product development and raising awareness for BDS.

Sustainable

- Institutional and operational sustainability linked with good management practices in service organization.
- Financial sustainability linked with demand for services, commitment of central, local governments to SME/private sector development, development partner priorities.

Development of human and natural resources

Empirical studies show that human capital is a significant determinant of growth.[30] While a large proportion of BDS involves short-term professional (for entrepreneurs and professional staff of SMEs)

29. Swisscontact (2003).

30. Based on a new database, Bassanini and Scarpetta (2001) provide empirical support for the growth-enhancing role of human capital in OECD countries. Accordingly, one additional year of schooling would,

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and vocational (for the workforce) training, it cannot substitute for deficiencies in the education and training system of an economy. The ability of SME to adjust to the competitive pressures that come with trade liberalization and globalization will very much depend on the level of skills that are available within transition and developing economies.

Transition and developing countries, particularly the least developing countries are investing significantly in their education (mainly basic) and training systems within the scope PRS. At the same time, the linkages between education and training strategies and SME/enterprise development strategies are still weak, resulting in weak market signals for policymakers and administrators. Although entrepreneurs may not be citing quality of education and training as a major obstacle to their business in large surveys (see Table 2), this may perhaps be due more to survey designs. A primary reason for such weak linkages has been the low level of prestige SME development has enjoyed in national development frameworks, including the PRS. A first step should be the mainstreaming of SME development into national development frameworks. A second reason may be traced back to the absence of effective public/private dialogue mechanisms in developing economies. Examples of consultations with the SME/private sector regarding needs while developing education and training strategies and curricula development are few. This is especially pronounced in the technical and vocational training systems in least developed countries, where some vocational programs are developed with great effort over some time, but cease to exist rapidly due to low level of demand from students, who are apparently more attuned to skills demand in the economy than the decision makers.

Although BDS cannot replace basic education, long-term technical and vocational training or university training, there may be benefits in linking education and training institutions as BDS providers to SMEs. A case in point is the experience of the Ho Chi Minh City University of Technology: the University was assisted to build up capacity as a short-term training and consultancy provider for SMEs in Ho Chi Minh City by a UNIDO project. The managers of the BDS programs reported that as a BDS provider for SMEs, they were able to bring hands-on experience into their curricula.[31]

The education and training systems have the opportunity to influence the level of entrepreneurial activity in transition and developing economies, where new and innovative enterprise creation is a priority. A recent study conducted in 14 OECD countries indicate that 19% of entrepreneurs interviewed associated the level of entrepreneurial activity in their country with lack of financing, 17% with the lack of education and training for entrepreneurship, 16% with negative cultural and social attitudes, and 15% with burdensome regulations.[32] Developing an appreciation of enterprise in the wider society is a long-term undertaking and it can best be achieved through the education and training system. While this is so, there are very few, if any, attempts for incorporating entrepreneurship training in school curricula. For instance, vocational and technical schools produce a graduate with vocational and technical skills that would enable him/her to take either one of two career paths: as an employee in a business or as an entrepreneur. In a significant number of transition and developing countries, no provisions are made to enable these graduates to learn the basic entrepreneurship skills while at school. Entrepreneurship skills training seem to be available mostly as BDS for adults.

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on average, lead to about 6 per cent higher GDP in the long run. In Greece, Ireland, Italy and Spain, the improvement in human capital has accounted for over half a percentage point higher growth in the 1990s compared with the 1980s. These results contrast with earlier studies where an insignificant effect of education on growth was found.

31. Tas and van Oyen (2000), p. 22.

32. OECD (2001), p. 75.

A primary reason for this is the lack of appropriate linkages between SME policies and those of the education and training sector.

Incorporation of entrepreneurship training into secondary school curricula may also address skills deficiencies women have, as they launch themselves into business. A major shortcoming of women entrepreneurs is cited as lack of entrepreneurship skills in a large number of studies.

In some developing and transition countries, especially in Sub Saharan Africa, the health of the SME workforce and the level of entrepreneurial activity in economies are under the threat of diseases such as Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome (HIV/AIDS), malaria and tuberculosis. SME competitiveness is hampered, for instance, by increased costs due to increasing health related absenteeism, reluctance of business-owners in providing on-the-job training to their employees, lower level of skills in products of the education and the training system due to loss of teachers and so on. SME development strategies need to mainstream awareness raising regarding these health issues and include health into the public/private dialogue agenda for additional measures.

While human resource development issues are fundamental to improving SME competitiveness, an SME development strategy should also address issues such as sustainable use of natural resources. Agriculture and agro-processing, including use of forest and marine resources and tourism figure predominantly among the industries where developing countries have comparative advantages. SME development strategies, while emphasizing environmental sustainability in a general sense, may also prioritize the promotion of good housekeeping practices in small businesses resulting in improved productivity without the need for major investments and utilization of cleaner production techniques to cut down production costs, thereby contributing to improved competitiveness.

Supporting infrastructure

Infrastructure investments, such as those in transport, telecommunications, energy, water and sanitation, can enhance SME/private sector activity and ability to access local, regional and global markets. Furthermore, quality of available infrastructure has a significant influence on SME competitiveness (*e.g.* costs associated with inefficient infrastructure) as shown for a selected number of transition economies in Figure 5.

It is important that infrastructure services reach all segments of society – such as the poorest areas and rural areas – in order to enable SMEs of different sizes and from all areas to participate in economic activity. A case in point is an IFC-backed project that has installed and operated a nationwide cellular network in Bangladesh and extended its services to rural women entrepreneurs, who were enabled to purchase airtime at wholesale prices and retailed it at the village level. The Grameen Bank provided micro-credit for the cellular handsets. A pilot program showed that women were netting an average of USD 2 a day or USD 700 a year from the village phone operations – about twice the country's annual per capita income.[33]

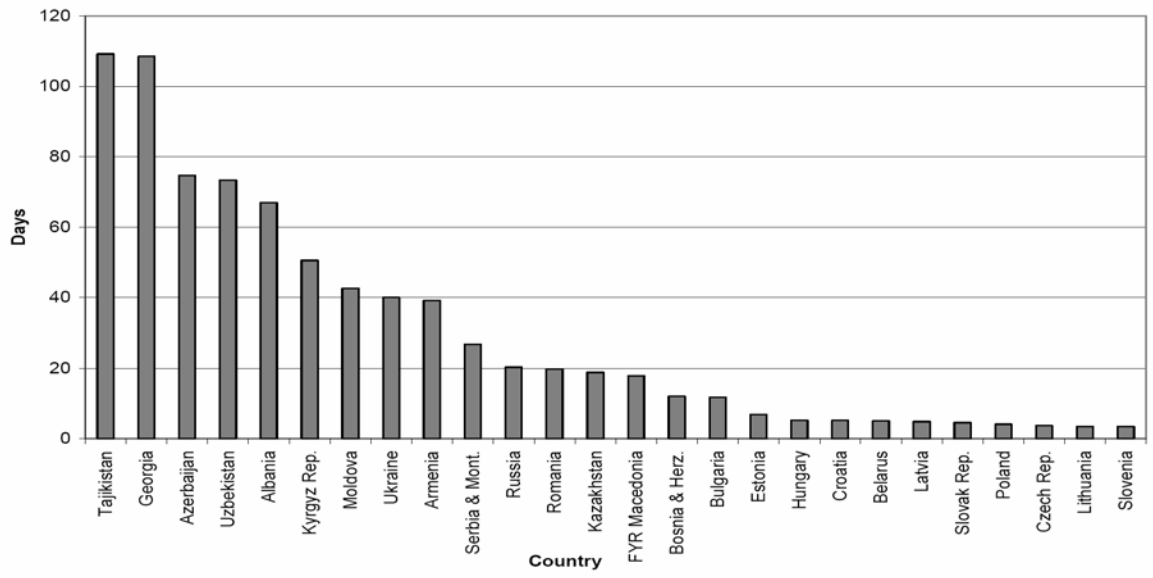
Infrastructure affects all size of business: power cuts, roads swept away by floods, absence of port and railway facilities affect SMEs as well as large scale businesses. However, incomplete or under-maintained infrastructure particularly affect the livelihoods of the rural poor in developing and transition countries, since large proportions of rural poor are involved in agriculture, agro-processing, including fisheries, for instance, and low quality infrastructure prevents the commercialization of production based on rural resources. Additionally, poor infrastructure results in low levels of

33. World Bank (2002), p. 3.

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entrepreneurial activity in rural areas, and large scale rural to urban migration, thereby putting pressure on urban infrastructure, employment in urban areas and so on. Starting around 1970s industrial estates for SMEs have been employed as an instrument for development of depressed regions in a large number of developing countries (see Box 12).

Figure 5. Total number of working days lost due to failures in provision of infrastructure services



Note:

1) Total number of working days lost due to failures in provision of infrastructure services is calculated for each country as an unweighted average of firm-level sums of days lost due to power outages or surges from the public grid, insufficient water supply and unavailable mainline telephone service.

Source: Fries, Lysenko and Polanec (2003), p. 21.

A number of developing countries, *e.g.* India, Korea, and Turkey, have been among the champions of industrial estate development for SMEs throughout the last few decades. Geographical agglomeration, although by itself not sufficient, can potentially help firms, especially smaller ones, overcome constraints associated with size, promote technological development and productivity enhancement, and enhance their ability to compete in local and global markets (*see Chapter 3 for more on cluster development as a strategy for export development and technology upgrading for SMEs*). Among the OECD countries, Italy is well-known for breeding SME competitiveness among its geographically agglomerated SMEs, especially in Northeast and Central Italy.

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Box 12. The Development of Korea's Cholla Region

For nearly three decades, Korea's economic miracle did not include the southern region of Cholla. Through the 1960s, as the country's economy expanded at a rate of nearly 10 percent a year, regional income disparities grew between Cholla and the two most industrialized regions, Seoul and Kyungsang. In the 1970s, despite government policies aimed at spreading population and jobs to less developed areas, industries seldom relocated to South Cholla, the country's poorest region.

Between 1975 and 1984, the World Bank approved three projects to help the government develop Cholla and reduce inter-regional inequalities. The projects were very complex, together covering seven cities and five islands in two provinces, South Cholla and North Cholla, with a total of 22 components. These included industrial, housing, and tourism estates (including national parks); city markets; bridges connecting islands to the mainland; fisheries; and urban services such as water supply, sanitation, and roads.

They had two major direct impacts: they triggered industrialization in the region and created the opportunity for local officials to learn and manage the development process, initially with help from central government agencies and later by themselves, with strong private sector participation.

Industrialization: A solid industrial base has been established. With the first industrial estate project, local and provincial governments successfully attracted some large "anchor" firms to the new industrial estates. Small- and medium-sized firms soon followed, investing in new plants and equipment. Subcontracting firms quickly cropped up. Demand for space grew so quickly that even before the first Bank-assisted industrial estate was fully occupied in 1984, it became clear that an expansion would be needed.

Industrial infrastructure has expanded to more than five times the project's original investment in the industrial estate of Kwangju. The study team found that the supply of electricity was better in the project area than outside. Firms also reported that utilities and other infrastructure services had improved for them inside the project's industrial estate. In interviews with the study team, private industrialists always stressed the Bank's catalytic role in initiating the development process in the region and the way that the projects brought together the public and private sectors.

Institutional learning: One of the most significant, yet unexpected, impacts of the program was the extensive and rapid learning achieved by local authorities, who had to operate project facilities and expand them urgently to meet additional demand. The projects offered both national and local government officials the first opportunity of its kind to learn project preparation and implementation for development of the region. They also gave local officials their first chance to work with central government officials as a team.

Source: Precis No. 145, Operations Evaluation Department, World Bank, April 1997, www.worldbank.org/oed

Evidence shows that infrastructure investment in developing countries does not suffice and that poor maintenance is results in decaying of investments prior to achieving full benefits from them. Local SME involvement in the development (*e.g.* community based power generation through private SMEs in remote areas in a number of less developed economies) and maintenance of infrastructure projects has proved very successful in terms of sustainability. However, investment (both foreign and domestic) in infrastructure has fallen considerably, but realization of the negative consequences of this trend is causing the pendulum to swing back again. The time is therefore very opportune to examine the issues surrounding pro-SME (and pro-poor) infrastructure provision.

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CHAPTER 3

BUILDING UP TRADE AND INVESTMENT CAPACITY OF SMES

As we have tried to illustrate to this point, framework conditions for building up SME competitiveness include an SME enabling legal, regulatory and administrative environment, SME access to finance, a supportive SME institutional support structure, availability of appropriate skills and supporting infrastructure, mainstreamed into the national development framework. In this chapter, the focus will be on a particular group of SMEs that are exporting or have export potential and those that are able to insert themselves into the supply chains of FDI enterprises.

Supporting SME export development[34]

Globalization has created new opportunities for SMEs. Progressive globalization over the last two decades or so has created a new international environment for SME exports from developing countries. The process of world economic integration has involved a broadening and deepening of inter-relationships between international trade and foreign investment flows. Several influences – falling trade barriers, increasing technological progress, migration of technical and professional manpower and highly mobile multinational corporations (MNCs) seeking out new investments – have combined to drive globalization. The end result has been the creation of an international market-place for goods and services that seems indifferent to national borders and state regulation.

But globalization also brings new challenges. The new international environment provides new opportunities for SME exports from developing countries. It has the potential to offer SMEs in developing countries with access to a global pool of new technologies, skills, capital, markets and hence faster export growth and profits than ever before. At the same time, however, globalization brings about a multiple array of trade challenges and a sudden increase in competition from imports and the entry of new foreign investors for SMEs in domestic markets. SMEs in developing countries have to adjust to the competitive strategies of MNCs in different countries, to public and privately set standards (*e.g.* sanitary and phyto-sanitary), to changes in international tastes, prices and competitive conditions.

The Doha Ministerial Declaration acknowledged these new difficulties. At the Doha Ministerial meeting in November 2001, WTO Ministers acknowledged the difficulties the new economic global context created for developing country governments and enterprises and committed to provide enhanced *market access, balanced rules and well-targeted, sustainably financed technical assistance and capacity building programmes*, to enable developing countries to secure a share in the growth of world trade commensurate with their economic development needs.

34. Based on Wignaraja (2003), Smallbone (2003) and OECD (2004): Summary Proceedings of the Regional Workshop on Trade Capacity Building and Private Sector Development in Asia. Two sub-sectors, agribusiness and garments, will figure more prominently in the discussions in this Chapter, as these sub-sectors earn a significant proportion of the export revenues in developing countries and are mostly populated by SMEs.

At the macroeconomic level, sound government policies and the ability to stabilize a competitive real exchange rate is the cornerstone of promoting exports. A competitive real exchange rate provides an incentive for exports. Moreover, an outward oriented, market-friendly trade regime, which emphasizes the dismantling of import controls and tariffs (permitting access to inputs at world prices), and streamlined bureaucratic procedures, *i.e.* export and import procedures, modern customs administration and efficient value added tax administration will facilitate exports, including from SMEs.

Wignaraja (2003)[35] suggests that globalization opens up new opportunities for export expansion and growth to about 5-10% of SMEs in developing economies. These dynamic SMEs have designed well-adapted marketing strategies and invested in their manufacturing capabilities to bring them up to world standards of price, quality and delivery (hence complying with new technical, environmental and labour standards in export markets). Some have even formed networks or industrial clusters with other SMEs or MNCs to stimulate the emergence of production networks among firms and increase value addition. Such SMEs have expanded their existing domestic market shares, broken into new export markets and continuously upgraded their products and processes. Experience of exporting SMEs from developing countries illustrates the fact that they have pro-actively upgraded themselves (see Box 13).

Firm-level strategies are fundamental to development of exports by an SME. However, accomplishment of a pro-active upgrading menu, such as the one shown in Box 13, among others, requires easy and cost-effective access to information on consumer demand and new technologies, training and advisory services to upgrade management practices, a skilled pool of labour in the country to select from, testing, quality assurance and certification institutions, and most importantly access to finance to upgrade technologies.

To illustrate a few of the challenges; developing countries, especially the less developed are yet to reap the full benefits of spread of ICT. For exporting SMEs, which are financially better off, it is not so much a matter of the availability of ICT in the country, but more of reliability and cost of ICT services – a matter that hampers access to information.

Technical assistance in the areas of quality management, productivity improvement and metrology is needed to help SMEs comply with the product standards and regulations applied in export markets. While the advance of trade liberalization brings down tariffs and quantitative restrictions, new barriers to trade, such as the technical barriers to trade (TBT) and sanitary and phytosanitary standards (SPS)[36] require disproportionate efforts from developing countries and are perceived to be unequally and sometimes unfairly applied by developed countries. Indeed, for instance, market access of developing-country agribusiness products (an earner of significant export earnings) is increasingly hampered by TBT (*e.g.* regulations, product standards, testing and certification procedures) and SPS (*e.g.* food safety and animal and plant health standards).

35. Wignaraja's estimates are based on a 1997 OECD study of 18 OECD and 8 East Asian economies.

36. Many poor countries confront a multitude of challenges in dealing with TBT and SPS requirements: they are unable to keep up with the "scientific" basis upon which these standards originate, they are unable to invest in the physical infrastructure to meet quality control, assurance and certification requirements, they are unable to invest in organizational, institutional and human resource development requirements in time with the changes, and at times, they are unable to counteract new TBT and SPS measures with equal force, due to the unbalanced power relationships between respective countries, even when they may have evidence that TBT and SPS are used as protectionist instruments. This issue requires joint action from developing countries in order to develop capacities to improve compliance with TBT and SPS.

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Box 13. Pro-active firm-level strategies

Business strategy:

- Know what your consumers want and what your market is
- Be adaptable; think of new products
- Cooperate with other firms
- Pro-actively upgrade

Pro-active upgrading means:

- Systematically acquiring production and product design capability
- Improving metrology (measurement), standards, quality and productivity
- Recruiting qualified staff and training
- Forging sub-contracting links with other firms
- Making use of technology institutions and other business services
- Actively seeking foreign buyers and marketing agents

Source: Wignaraja (2003) and others.

In developing countries, particularly the less developed ones, technical advisory and consultancy services are scarce due to low levels of investment in developing engineering skills. Although management consultancies are emerging, the affordability of such services, especially for potential exporters are quite questionable. Services for ISO9000/ISO14000 certification are mainly provided by foreign invested consultancies and highly priced. Testing laboratories are mostly confined to the national standards organizations, which usually do not provide advisory services that are needed to deepen the understanding of product and process standards by SMEs that may have export potential. Private testing facilities are virtually non-existent or available only as in-house operations in large-scale firms and are not open to public use/SMEs. Sectoral business membership organizations are newly emerging and lack own finances to invest in technology upgrading services for SMEs.

Appropriate measures to maintain and to further improve the competitiveness of exporting SMEs and to draw additional SMEs into exporting might include grants for SMEs to obtain ISO9000/14000 certification, setting up accreditation facilities, establishing productivity and design centres to upgrade SME design to international standards; and assisting SME membership organizations, especially those at the sectoral level, to launch common technical facilities and centres for SMEs.

Access to SME trade finance at competitive interest rates can be strengthened through export credit guarantee schemes for SMEs; and subcontracting and specialist soft loans for SME export activities. Government should encourage state-owned banks (*e.g.* if available, the specialized SME Development Banks), as well as private enterprises (commercial banks, venture capital funds) to provide financial services tailored to SME export-related needs.

The agribusiness sector is important in almost all developing countries, including the more developed ones. The sector is characterized by SMEs that have high backward linkages with the rest of the economy, contribute particularly towards poverty reduction, job creation and improved health and nutrition. Stability of the agribusiness sector also requires diversity of both products and markets and primary attention to sustainability of resources.

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The agribusiness/agro-industry sector can provide a domestic basis for scaling up of enterprises to the point where they become capable of export. There are also practical difficulties involved in starting up an agribusiness enterprise targeting an international export market from the beginning. In many cases, the domestic and regional markets tend to provide a stepping stone from which SMEs can learn important lessons concerning product quality, timely deliveries and managing risk involved in international business. Where there is an inadequate domestic market, or the products are only attractive for export, considerable effort needs to be put into strategic positioning and reliable production so as to reduce risk of failure. Such effort is obviously costly and requires capacity building of SMEs and export development institutions, including sectoral membership organizations.

Market access of developing-country agribusiness products is increasingly hampered by TBT and, specifically, by SPS-Sanitary and Phytosanitary Standards.[37] Moreover, the change in these non-tariff barriers can cause considerable fluctuations in returns from investment in agribusiness.

There is an important role industry associations can play in helping firms to deal with challenges such as SPS, developing vertical and horizontal linkages and upgrading along the value chain. Hence, agribusiness associations in specific sub-sectors are of central importance in dealing with export-related concerns of SMEs, which initially justifies both government and development partner support. While individual business interests might prevail over wider industry interests during early stages of the work of membership organizations, the ability to plan strategically and contribute to sector development emerges over time.[38] It is also important to accept at the outset that financial support for associations does not mean that the associations will always agree with the government or the development partner. The case of Vietnam, which has recently emerged as a successful exporter of seafood into OECD markets, is instructive, regarding the potential role of business membership organizations (see Box 14).

Additional advantages that are contributing to Vietnamese seafood exporters' success are the availability of a highly qualified workforce at competitive costs, relatively well-established testing facilities, a closely-knit network of overseas Vietnamese in OECD markets, who act as sources of information on foreign markets and consumers as well as foreign buyers, and the early streamlining of import and export procedures and modernization of customs facilities by the Vietnamese government.

What is critical in agribusiness/agro-industries is that measures must be in place at a very early stage to ensure high standards of traceability and hazard control throughout the entire value chain. As this requirement cannot be added later, a significant proportion of trade-related technical assistance in the agribusiness sector has to be devoted to improving capacities in satisfying TBT and SPS. Sometimes joint ventures with foreign firms and business relationships with buyers – such as supermarkets – can help meet quality and safety standards (*e.g.* Thai firms engaging in joint ventures

37. Otsuki, Wilson and Sewadeh (2001) quantify the impact of standards on aflatoxins implemented by the EU on food exports from African countries. The authors estimate the impact of changes in differing levels of protection based on the EU standard and those suggested by international standards, for 15 European countries and 9 African countries between 1989-1998. The results suggest that the implementation of the new aflatoxin standard (2 ppb) in the EU will have a significant negative impact on African exports of cereals, dried fruits and nuts to Europe. The EU standard, which would reduce health risk by approximately 1.4 deaths per billion a year, will decrease these African exports by 64 percent or US$ 670 million in contrast to regulation set at an international standard (CODEX guidelines of 9 ppb), p. 18.

38. Dengate (2003).

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with Japanese buyers have increased their ability to meet stringent quality requirements of the Japanese market, yet have also become dependent on their partners for marketing and distribution).[39]

Box 14. Vietnam Association of Seafood Exporters and Producers (VASEP)

VASEP was established in 1998 and has 176 members. The association represents and protects the rights and interests of the seafood industry of Vietnam.

It provides its members various benefits, including:

- Supply of information regarding export markets and market price (*e.g.* through weekly and monthly Seafood Trade Newsletters; reports posted on their website, etc.)
- Strategy to deal with non-tariff barriers: VASEP calls for tighter quality control and tracking of suppliers; lobbies government for higher investment in testing facilities; provides information regarding SPS requirements, and represents the industry during disputes.
- Advice for business management
- Participation in international seafood events (*e.g.* trade fairs)

Source: Nguyen (2003); www.vasep.org.

In a significant number of developing economies, the garments sector constitutes the majority of light manufacturing and more than 50% of exports. For instance, taking a closer look at some of the South and South Asia economies reveals that garments account for 50% of exports in Laos, 52% in Sri Lanka, 85% in Cambodia, 75% in Bangladesh and 67% in Pakistan. Similarly, other light manufactures such as footwear and electronic equipment represent an important share of exports in Thailand and Vietnam.

Globalization is progressing rapidly. Unfortunately, governments and firms in developing countries have been slow in responding to upcoming changes such as the phasing out of quotas as per the Agreement on Textiles and Clothing (ATC) on 1st January 2005. The ATC had allowed a 10-year transitional period, for the elimination of quotas that were carried over, when the Multi-fibre Arrangements (MFA) expired in 1994. Developing countries have been scrambling to adjust to an era of more intensive global competition in textiles and clothing trade by seeking duty free access to large OECD markets through bilateral trade agreements. Some have been successful and some are still trying. Diverse interests have prevented the formation of collective approaches within regions. However, at the national level, motivated by a sense of urgency, it is possible to observe high level, joint public/private sector committees (at times headed by Prime Ministers) convening at short and regular intervals to identify solutions to the looming challenge in textiles and garments trade.

The prospects of intensive competition have also given the stakeholders an impetus to assess the weaknesses and strengths of their garment industries. Developing countries having diversified product ranges, including high-end products and markets (*e.g.* branded intimate apparel in Sri Lanka), and countries that have invested in backward linkages (*e.g.* investments in selected inputs in Bangladesh) and started developing forward linkages are in a better position. Strategies that would support diversification, differentiation and specialization within economies, sectors and at the level of firms appear viable and need to be given consideration in designing trade-related technical assistance. A value chain approach to identify bottlenecks and opportunities for designing strategies aimed at strengthening the competitive edge of firms may be appropriate.

39. Nikomboriak (2003).

Purchasers' codes of conduct and business practices, particularly, in the textile and garment sectors have come to play a greater role in purchase decisions made by OECD-based buyers. Requirements may be limited to worker rights undersigned internationally and environment-friendly process requirements, but they may also include among other things stringent and detailed factory standards regarding the technical specifications for storage and social spaces, and audits to confirm compliance. Adherence to corporate social responsibility standards and codes requested are a double-edged sword. On the one hand, they may burden the firms disproportionately, as each buyer may require different standards; on the other hand, they can lead to improvements in the industries, add to competitiveness and ethical sourcing and buying, and respond to a less price-elastic, niche-type demand.

Developing and transition economy governments do have an option to confront the challenge of improving export competitiveness of their SMEs. This may be achieved by developing a national strategy for export development and promotion, led by the appropriate ministry, but which involves participation by all key stakeholders, as emphasized in Chapter 2. The overall objective should be to increase the volume and value of exports and the number of exporting companies, including SMEs. The strategy should seek to address the needs of firms at different stages of export market development. It should also seek to integrate export support and promotion into a well developed and effective business support system.

The export-supportive institutional infrastructure already discussed in this chapter, should be firmly embedded into the SME institutional support structure portrayed in Chapter 2. Furthermore, a single export development and promotion agency, which would pursue the national export development strategy, would be needed. Based on good practice in mature market economies, the establishment of such an agency should separate policy making from policy implementation. The agency should:

- Operate in a commercially oriented manner.
- Be result rather than procedure oriented.
- Be staffed by people with relevant, practical business experience.
- Seek to be customer-oriented.
- Include private sector representation on its Management Board.
- Be funded commensurate with its objectives.

The export development and promotion agency, which could be combined with an FDI function, should develop an export support "offer", including:

- Provision of information about specific markets and potential customers.
- Help in making contact with potential customers or appropriate public and private intermediaries and business service providers.
- Assistance with market visits.

Cluster development strategies are attracting more interest as local SMEs are linking to global value chains, as a result of targeted initiatives (see Box 15).

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Box 15. Marketing and Export Consortia in the Bangalore Hand Tools Cluster: UNIDO support

The objective of this specific project intervention was to increase market reach for the smaller firms of the cluster through joint marketing. As a by-product of the process, an enhanced level of mutual understanding was expected to lead to a broader platform for collaboration among these units. This objective was tackled by first spelling out in detail marketing-related problems, followed by the creation of a pilot network whose members had an ideal mix in terms of production leading to trust building among firms (from relatively simple joint marketing ventures to more complex ones). The results thus achieved were then actively disseminated by the cluster development agent (CDA) to replicate the experience throughout the cluster.

The diagnostic study and the ensuing two validation workshops (one with manufacturers and the other with support units) revealed that marketing was the principal area of concern for the cluster firms. Moreover, informal visits and discussions that followed revealed that proactive marketing was perceived as a high cost proposition. In small group meetings, however, some firms agreed that common marketing could be a viable solution for such a problem.

One of these informal groups displayed a rapid change in attitude as a result of the inputs provided by the CDA and established itself as an informal network of 8 firms supplying complementary machine tool products. With active stewardship by the CDA, group members built up trust in each other, eventually accepting to legally register their consortium as the Bangalore Machine Tool Manufacturer's Association. At this stage, firms agreed to hire a common consultancy firm for quality upgrading (ISO-9001). Although this was not an area of immediate concern, firms agreed to experiment joint action on this front as it required little sharing of "critical information" and returns were high and relatively certain. Initially, entrepreneurs would not agree to meet other consortium members within their premises. As inhibitions faded away, however, the entrepreneurs were paying group visits to each other's shop floors.

While work on quality upgrading was under way, the members agreed to produce a common brochure, which would help them identify potential customers in their endeavour of proactive marketing. Thereafter, they participated jointly in fairs. The success derived from these new marketing channels gave them confidence in jointly exploring new export destinations, namely the Chinese and Brazilian markets. At this stage firms started sharing orders with other consortium members.

The message of success soon spread around the cluster and another group of small manufacturers with complementary products settled directly for a common marketing brochure and joint participation at fairs. They rapidly went on to appoint a marketing agent in Bangalore. Confidence gained in the process led the two consortia to invite large firms to visit their factories, so they could evaluate their production capacity. New orders started to be registered through these new channels. Very soon, 6 new networks came into existence and were exploring new marketing channels: a common web site, common dealers and common advertisements.

Initially, the project supported up to 50% of the costs of the initiatives launched by the consortia. Gradually, this was reduced and the groups were covering all expenses related to marketing by themselves.

Presently, 45 cluster firms (nearly one third of the cluster population) are organised in five consortia that had generated additional sales worth little under 1 million USD by the time the project was operationally completed in December 2002 (when business enquires for further 10 million USD had been received by the consortia). Three new Indian markets and two new export destinations were actively explored and generated new orders. Member firms produced eight new common brochures and four joint marketing set-ups, two common marketing offices within India and two common web sites.

Source: UNIDO (2004), p. 20.

The 1995 cluster development policy checklist that Nadvi drafted (see Box 16) still seems to hold true. The checklist emphasizes the importance of creating enabling environments at macro, meso and micro levels through sound macroeconomic policy, capacity building of support structures, and business strategies based on differentiation, niche markets to achieve competitiveness based on quality, consumer preferences rather than low costs. In this respect, cluster development strategies

serve both improving competitiveness and improving the ability of local SMEs to insert themselves into global supply chains through linkages with FDI and may be a useful tool for an SME export development and promotion agency, with or with a function in promoting linkages with FDI.

Box 16. Eight point programme & policy checklist for supporting SMEs in industrial clusters

1. Identify existing clusters and networks of SMEs, however nascent. Such forms of production organization generate significant economies for small producers, encourage backward and forward linkages and raise prospects for collective action. Attempting to set up clusters and networks by administrative fiat, it should be noted, rarely succeed.

2. Policy must concentrate on groups of producers and not individual small firms. Furthermore, intervention needs to be targeted, sector specific and strategic. Generalist support programmes tend to have limited impact.

3. Focus on demand led product markets and the imperatives that they engender: namely achieving competitiveness on the basis of quality consciousness, fashion sensitivity, reliability, rapid delivery and not price alone.

4. Concentrate on institutions and instruments that facilitate the inter-face between producers and the market, such as trade fairs, export visits and external buyers, for accessing marketing information, product development, fashion trends and for acquiring technical know-how.

5. Support local and sectoral institutions that provide producer services such as technical training, technology support and market information. Use local levels of government for such support intervention and collaborate closely with representative business organizations and local self-help institutions.

6. Use large firms as important agents of change by promoting supplier upgrading programmes, also as part of industrial restructuring strategies of large producers.

7. Work towards a macro-economic framework that provides for a levelled playing field and an incentive structure that allows SMEs to operate on fair terms.

8. Finally, do not smother. Intervention appears to be far more effective in cases where policy agents have acted as facilitators and enablers. This gives scope for private initiatives and entrepreneurial energies to come to the fore and to strengthen the development of clusters and networks.

Source: Nadvi (1995), p. 74.

Strengthening SME-FDI linkages[40]

Trends in FDI in developing and transition economies

The vast majority of FDI originates from the developed world, with 30 host countries making up 95% of the total in 2002 (UNCTAD, 2003). Similarly, developed countries remain to be the main destinations for FDI, accounting for three-quarters of the world's total. However, FDI inflows can represent significant sums for developing countries, several of which record levels of FDI that are large when considered in relation to the size of the domestic economy (OECD, 2002a). On the other hand, the distribution of FDI between developing and transition economies is very uneven. For example, recent evidence indicates that FDI to Africa and Latin America represents a smaller

40. Based on Smallbone (2003).

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proportion of the world's total than it did in the mid-1990s (Morisset, 2000), although the volume has increased.

There are also medium sized firms from mature market economies investing abroad – an FDI by SMEs (*e.g.* Japanese SMEs following Japanese FDI as first tier suppliers to transition and developing economies, or Chinese Taipei SMEs expanding markets to lower labour cost locations) (see Box 17). Such developments offer both opportunities and threat for local SMEs: opportunities for sub-contracting linkages as second tier suppliers to SME-FDI; threats may be that by bringing their own suppliers, MNCs may be raising entry barriers to local SMEs as suppliers, at least in the short-term.

Box 17. FDI Activity by SMEs in Chinese Taipei

As a small open economy, development in Chinese Taipei depends on international trade. Despite lacking in experience and resources, domestic SMEs are playing a major and increasing role in the country's outward FDI. Analysis of the motives of SMEs to go abroad emphasized low capital intensity (because of the desire to export more labour intensive processes to cheaper labour locations, *e.g.* mainland China); the greater involvement of larger firms within the SME size range; higher export ratios; and R&D intensity. The key motivating factors identified in relation to domestic SMEs investing abroad were utilizing local labour; to be close to expanding markets; and following major customers, which may enable firms to reduce operating risks overseas.

Source : Kuo, and Yang, 2001.

FDI-SME linkages and spillover effects

Many studies outline the potential benefits of FDI to host economies. These benefits include sources of external capital, technology and knowledge transfer, employment generation, skills enhancement and human capital development, and enterprise development through linkages and spillover effects. They also include increasing international trade integration.

The potential benefits of FDI to host economies and local SMEs have been summarized in five main types of linkages and spillover effects:[41]

1. Backward Linkages with Suppliers*:* This refers to the extent to which components; materials, and services are sourced from within the host economy, since this can create new market opportunities for local firms. Such linkages can range from arms length market transactions to deep, long-term inter-firm relationships. The productivity and efficiency of local suppliers can benefit from this type of spillover as a result of direct knowledge transfer, higher quality requirements and increased demand levels. Backward linkages with suppliers have traditionally been seen as the main vehicle to promote technological and other spillovers from MNCs into host economies.

2. Forward Linkages with Customers: These can include marketing outlets, which may be outsourced. Examples include petrol stations and restaurant chains; and linkages with industrial buyers, through, for example, value added after-sales services.

3. Linkages with Competitors*:* Foreign investors may set new standards, which local firms may seek to compete with. Although MNCs may hold a strong market position in relation to local

41. Dunning (1992)

firms, it should be noted that linkages with competitors may refer to second and third tier suppliers to leading inward investors, and not just first tier suppliers to the MNCs themselves.

4. Linkages with Technology Partners: Some MNCs may initiate common projects with indigenous SME partners, including joint ventures, licensing agreements and strategic alliances, which are an important potential source of technology and know-how for firms in the host economy. Whilst such co-operation may be a more common feature of more mature market economies, the number of inter-firm technology agreements involving partners from developing countries rose in the 1990s compared with the 1980s.[42]

5. Other Spillover Effects: These include demonstration effects, as inward investors demonstrate new and better ways of doing things to local firms, representing a source of, and stimulus to, innovation. They also include human capital spillovers, when, for example, trained personnel leave the inward investor to work for a local enterprise and/or set up their own business.

Enhancing FDI-SME linkages in developing and transition economies

Understanding the rationale for clients (MNCs) outsourcing products and services to suppliers (SMEs with capability to meet stringent quality, cost and delivery standards of MNCs) would clarify implications for SMEs and their development for enhanced FDI linkages. Studies indicate four main rationales for outsourcing:

- *Productivity gains:* Where suppliers are able to produce specialized inputs, the SME partner has a certain bargaining power. Such linkages are based on mutual specialization, typically going beyond arms-length transactions. They may involve a long-term commitment on the part of the customer, with considerable transfer of technology and knowledge. At the same time, it has been suggested that for FDI to have a positive impact, the 'technology gap' between domestic and FDI enterprises must be relatively limited.[43]

- *Factor cost advantages: e.g.* lower wage costs. In such situations, the supplier is potentially much more vulnerable than where productivity gains is the main rationale, because price competition is typically fierce, with continued downward pressure on prices and costs.

- *Numerical flexibility:* this involves occasional or overflow subcontracting, in response to demand peaks. In such circumstances, suppliers have to accept short-term contracts and face little security or stability.

- *Functional flexibility:* This also involves responding to fluctuations in demand, but in this case through active, functional flexibility, based on a multi-skilled workforce and flexible equipment. Such circumstances are more favourable for the supplier than the case of numerical flexibility, although the supply base required is less commonly found in a developing/transition context.

Assuming that sound macroeconomic policies and political stability characterize the business environment (since these framework conditions are the lowest minimum that will attract FDI),

42. UNCTAD (1998).

43. OECD (2002a).

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enhancing FDI-SME linkages is a matter of implementing support measures to improve the competitiveness of local SMEs. As discussed in Chapter 2 and for SME export development, SMEs would have to be immersed in an institutional environment that would encourage learning and innovations and trigger investments by SME to upgrade. Building the capacity of local SMEs will require facilitation by intermediaries.

Programs to establish and strengthen linkages between MNCs and SMEs would involve launching of technology and quality upgrading programs. In both cases, SMEs would have to be targeted on a "fit-to-supply" principle, as upgrading programs are costly, both for the "supporter" and the SME. A viable group to target may be SMEs that are already supplying large-scale enterprises within the country and those undertaking government contracts, since the clients usually implement more stringent conditions than the average client groups.

A program of FDI-SME linkage support would need to consist of two distinct components: a) a host of linkage promotion services, and b) technical and management upgrading services, including training and consultancies to internalize the requirements of the MNC, complemented by access to finance to integrate any new technologies into the existing production process.

The linkage promotion program may involve all or some of the following elements:

- Improving the flow of information about potential local suppliers to potential MNC purchasers and about supply opportunities to potential suppliers through the development of a national Website and/or business directories.

- Organization of "meet-the-buyer" events, including visits to MNC production sites, seminars where the MNC clarifies its procurement processes, quality requirements, etc.

UNIDO's sub-contracting and partnership exchanges (SPX) in transition and developing countries is an example of a linkage promotion service (see Box 18). Basically, an SPX compiles detailed technical information from SMEs: types of machinery and equipment, their make, model, power, capacity, state of maintenance, etc. which is then coded and loaded into a database. Data collection has to be done using a complicated form, in the premises of the SMEs by a highly qualified engineer or engineers of different backgrounds, as required. On the supplier's side, detailed technical specifications of work orders/tenders need to be compiled, coded and loaded into to a database. Then, the database is used to inform clients and suppliers of matching needs and requirements. The databases have to be kept up to date, for the system to function efficiently. Information collection is complemented by seminars and meet-he-buyer events.

Box 18. UNIDO Industrial Subcontracting and Supply Chain Management Program

UNIDO provides technical assistance to developing countries for establishing "Sub-contracting and Partnership Exchanges (SPX), acting as a broker; setting up a list of subcontractors for large firms, as well as a roster of suppliers and main-contractors. The UNIDO website includes directories of SPX in every participating country (32 developing/transition countries). The principle underlying this programme is potentially transferable into other contexts and sectors.

Source: UNIDO SPX Programme information: http://www.unido.org/doc/4547.

The capacity building program for technical and management upgrading would be quite costly and need long-term commitment from the SME, the MNC as well as the program sponsor. If the MNC has brought is first tier suppliers with it (as this is usually the case), then the first tier suppliers would have be target as partners in the first stage. Some of the elements in this part of the program may include the following:

- Working closely with MNCs/or its supplier by inviting them to help potential SME suppliers to a) understand their supply requirements b) identify areas in which they have good opportunities to supply and c) draw attention to weaknesses they must overcome in order to succeed. Such an intermediary role helps to build mutual understanding and trust between MNC and potential supplier. However, MNCs and/or their suppliers would not get involved in this type of a program, unless there are some incentives: these may be contributing to the salary costs of engineers and managers in MNCs who devoted time to supplier upgrading (Singapore), cash grants to promising suppliers to help with initial investment costs (Ireland) and subsidized training and consultancy necessary for enhancing supplier capability (Chinese Taipei)—a notable issue is that most of these expenses would have to be publicly funded, either by the government or a development partner.

- Helping SMEs/suppliers identify needs[44] and then to access the public and private support services they need. Again, medium to long-term training and consulting expenses would need to be funded, as the SME would most likely be unable to cover such expenses over the long period of time needed to build capacity. Furthermore, access to investment finance (medium to long term) would be necessary to carry on with upgrading of technologies.

- Developing capacity building programmes that include supply chain and cluster initiatives, which recognize the potential for developing tiers of suppliers to maximize trickle down effects, including to micro enterprises as lower tier suppliers.

The Enterprise Centre in Baku (see Box 19) is a good example of an MNC initiated linkage program. The oil and gas industry have long term (40 year) agreements with the Government of Azerbaijan and due to the nature of the industry, significant cost advantages accrue to the oil consortium through local linkages. Azerbaijan has a comparative advantage in oil and gas related manufacturing industries, with a large number of technical institutes and universities specializing in industry related fields. Skills levels are high; salary levels are relatively low. As the case of the Enterprise Centre illustrates a well-thought out promotion program, with relatively low levels of capacity building needs (not in technical fields, but mainly in management) has started yielding good results. A primary cause is the high existing level of human and physical infrastructure available.

44. Needs assessments would also require use of capable external consultants and usually cover assessment of the production process, maintenance systems, engineering and labour skills available. Then, these deficiencies would need to be addressed through training and investment in upgrading equipment, at least partially. Additionally, installation of quality assurance and new management systems and practices such as cost accounting, staff incentives would be required.

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Box 19. Enterprise Centre-Baku

The Enterprise Centre, Baku is an example of an MNE-initiated business development and linkage centre for same-sector local suppliers. With its foreign partners, BP opened it in 2002; with the aim of helping local companies develop business in support of oil and gas developments in Azerbaijan. BP's primary stated business objective is to increase local content of its projects, which could result in considerable cost savings, as well as increasing local supplier capacity.

The Centre is headed by a highly qualified Azeri business executive, compiles a database of "fit-to-supply" Azeri firms, and disseminates information on the Health and Safety Standards BP and the oil consortium uses. Additionally, the Centre regularly runs executive level training courses for Azeri company managers: ISO9000/quality assurance systems awareness raising, social corporate responsibility, negotiation skills, etc. EC News is a daily, internet based newsletter, which announces procurement requests, information of Azeri businesses receiving quality certification, opening of new testing facilities in Baku, etc. The Centre also provides consultancy on the requirements of the oil industry.

An example of an FDI-SME linkage arising from this project is between McDermott Caspian Contractors Inc. (an international manufacturing company for oil supplies), and local Azerbaijani suppliers and contractors. These local firms made up nearly 70% of all purchases MCCI undertook in connection with its own contract with BP between June 2002 and May 2003.

Source: Enterprise Centre News (www.ecbaku.com/news).

Improving Aid Effectiveness: the role of donors

Policy coherence and a joined-up government on the transition and developing country side are essential for managing aid effectively. In fact, one of the objectives of implementing an SME development strategy and embedding it into national frameworks is to achieve policy coherence and joined-up government. Therefore, transition and developing countries need capacity building assistance at an early stage in the preparation of SME development strategies.

SME development has a long history of evolution in almost all donor countries, and different donors working different countries. There are also fundamental differences in donor approaches to SME development, including among the approaches of senior international experts fielded by donors during capacity building. The SME field is wide, and experiences are many. These considerations have the potential to introduce confusion on the part of the partners, with different donors giving non-complementary, at times, conflicting advice, also resulting in disconnected interventions. Donor coordination is crucial to improve efficiency and effectiveness of resources both on partner and donor sides. Such coordination should be based on joint analytical work towards assessing and prioritizing needs.

Implementation of an SME development strategy needs the participation and collaboration of numerous stakeholders. Getting the fundamentals right in the legal, regulatory and administrative frameworks have the greatest impact on SME development in most contexts. However, policy advice at this level should not be limited to drafting of policies, legislation and regulation. Without proper administrative capacities, especially at local levels, where the entrepreneurs have their contact with the improved frameworks, it would be difficult to achieve the intended results. Therefore, more and additional donor resources should be channelled to capacity building for "implementation" at central and local levels.

Functioning public/private dialogue mechanisms contribute a great deal to trust and consensus building among stakeholders, as well as ownership. Although so useful, it is difficult to build such

relationships; they take time. Therefore, unrealistically tight schedules are bound to fail and cause discouragement all around. Having both national and international facilitators to backstop these processes, and facilitating study visits abroad to observe both "good" and "not-so-good" practices usually add value to the process.

Improved understanding of donor field staff of SME development issues would improve effectiveness of assistance. This would also enhance coordination among different donors.

Dissemination of best practices, especially from OECD economies, should always be accompanied by historical, contextual information. What has worked in one country, would most likely not work in another country. Recommendations made to domestic stakeholders should always be accompanied with cost information. Particular attention should be paid to establishing new institutional structures, which may not be sustainable due to unavailability of operating costs when donor assistance concludes.

SME development is not an answer to all the challenges, and due to significant amounts of institution/capacity building involved; it is a long term and costly investment. Unless sufficient resources are allowed, expected results will not be achieved. Furthermore, supply side capacity building should go hand in hand with market access. Members of the DAC should bring SME dimensions fully into the work of its Network on Poverty Reduction (POVNET) on how to promote the contribution of private sector development to pro-poor growth.

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CONCLUSIONS

SME development cuts across sectors, involves multiple stakeholders and necessitates concerted actions by the public and private sectors. Therefore, SME development should be mainstreamed into the national development framework. Building up market institutions should be accompanied by capacity building of appropriate institutional structures.

Although competitiveness is a firm level phenomenon, macroeconomic and microeconomic environments influence market signals. To enhance SME competitiveness, therefore, requires the creation of enabling legal, regulatory and administrative environments, access to finance and capable institutional structures, and most importantly human capital and a sustainable environment.

Removing supply-side constraints to trade and investment requires firms to build up their competitive advantages. However, competitive advantage is measured in relation to rivals in the markets in which firms compete. Integration into regional and global trade and investment networks will require much effort, although it is not an impossible proposition. Public and private sectors in transition and developing countries must work together to improve the functioning of markets at home, while intensifying efforts to integrate into the world economy.

Donors (OECD and others) have much to contribute to this process. They can help to expedite the learning processes involved by sharing good practices, they can technically and financially assist transition and developing countries in overcoming barriers, most importantly, they can ensure that improved market access complements improved competitiveness of SMEs.

Improving the investment climate for SMEs, and strengthening their capacities to respond to trade and investment opportunities, does strengthen the economic performance of SMEs and this in turn has a positive impact on growth and poverty reduction. A DFID commissioned study[45] covering Central Europe and Africa showed that countries that adopted enabling environment reforms also witnessed greater per capita GDP growth.

There is, of course, no single way to support and strengthen SME competitiveness in a globalised world. Each country has to find its own way to strengthen the legal, policy and institutional frameworks in which SMEs operate and which set the quality of the enabling environment. A number of messages can be drawn from case studies:[46]

- Investment climate reforms need to take account of the national/local context and should be implemented in consultation with the private sector and with all levels of government.

- Prioritization and sequencing of investment climate reforms is important especially given the severe capacity constraints of most developing countries governments.

45. Bannock, G. *et al*. (2002).

46. See, for example, DFID contributions to the World Bank 2005 World Development Report.

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- Reforms and policies should be directed at generally helping the private sector to help itself (by removing obstacles) rather than providing direct financial or business support.

- More attention should be given to improving the enabling environment for indigenous private sector (in particular micro-business and SMEs) and this will also help attract foreign investment.

- What is good for the private sector in general is not necessarily equally good for small firms as the latter face proportionally more costs and biases than larger firms.

- The six main obstacles to investment and business activity to domestic and foreign firms of all size are: corruption; lack of infrastructure; policy inconsistency and instability; regulatory complexity and unpredictability; inadequate legal frameworks (including uncertain property rights) and labour problems.

- Over-regulation (in areas such as business registration/licensing; ownership forms; labour and taxation) increases regulatory costs which bear most heavily on small firms.

- Foreign investors would generally rather see a good overall business environment than elaborate incentives.

- Different countries coordinating their FDI policies at a regional level can bring benefits.

On the basis of the findings and analysis of this report, key components of an SME strategy include:

- *Embed national private sector/SME development strategies in the broader national development and/or poverty reduction and growth strategy through institutionalized, participatory processes*, as SME development entails improving 1) the ability of governments to implement sound macroeconomic policies, 2) the capability of stakeholders to develop conducive microeconomic business environments, and 3) the ability of SMEs to implement competitive operating practices and business strategies. Enhanced public/private dialogue and partnerships with stakeholders (public, private, civil society and academia) are essential for identifying obstacles, effective tailoring and prioritization of support measures, and making effective investments in necessary infrastructure and institutions. Furthermore, institutionalized public/private dialogue and partnerships enhance ease of implementation, political credibility and sustainability of SME development strategies. Donors and multilateral organizations (OECD and others) can play an important role in facilitating such dialogue and partnership.

- *Increase efforts to develop and strengthen enabling legal, regulatory and administrative environments at local, regional and national levels***,** where property rights are clearly recognized, contracts are easily enforced, transaction costs in setting up and doing business are minimized through fair, simple and less costly taxation, customs, licensing, registration, financial, judicial, and other governance systems and procedures. Consistency in implementing the rule of law for all, at all levels, determination in fighting corruption and lowering costs of setting up and doing business would also help entrepreneurs to "move away" from the informal sector.

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- *Facilitate availability of and access to loan and equity finance, particularly medium to long-term opportunities to improve trade and investment capacity of SMEs***.** While maintaining sound government finances will help availability of finance for development purposes, access to finance may be enhanced by ensuring that 1) contracts are easily enforceable (*i.e.* through functioning secured transactions and bankruptcy regulations and institutions), 2) issues of collateral and security are managed competitively (*e.g.* availability of loan guarantees for SMEs, computerized registration systems for pledges, mortgages, leases and where types of assets that may be used as collateral are expanded—*e.g.* to future acquired property), 3) financial institutions are managed prudently and are trusted by depositors, 4) legal frameworks enable a sufficient number and type of financial instruments to be used (*e.g.* transfer of negotiable instruments and commercial paper such as checks, bills of exchange, promissory notes) 5) financial institutions other than banks are functioning (*e.g.* insurance companies, venture funds), 6) SMEs are encouraged to keep good accounting records. Without access to medium and long-term finance within the economy, SMEs would not be able to make the necessary investments in innovations and technologies to improve their trade capacity and act as partners to foreign direct investors (FDI).

- *Strengthen infrastructure services delivery to facilitate market access and reduce the cost of doing business.* More investment is needed in key areas such as energy, transportation and communications. Attention should specially be given to sustainably managed infrastructure, lowering of energy, transport (road, air and seaport) and communication (including international telephone and Internet usage) charges, while improving the reliability of these services. Facilitating public/private partnerships and attracting FDI into basic infrastructure as well as for establishment of industrial parks and (if viable, incubators) for SMEs are options that should be considered.

- *Reinforce support structures for private sector/SME development, particularly institutional support.* SME development strategy should be coordinated and monitored at the central level through a lean, but high level institution and progress should be reviewed jointly by public and private sector (via the public/private dialogue mechanism). SMEs need business services to improve their competitiveness (*i.e.* information, consulting, training, accounting, legal, advertising, marketing, courier services, technical and technology services, including testing for standards and certification requirements abroad, product upgrading, etc.). Support structures that provide these services can be public or private, but over time the trend should be towards greater private provision (with subsidies, as necessary), so that rapidly changing needs of SMEs could be met. Linkage programs between SMEs and FDI (*e.g.* for facilitation of subcontracting arrangements) should be based on the principle of 'fit-to-supply' and assisted by development partners. Sectoral and general business associations should be strengthened to improve their market access services (*e.g.* business-matching, trade fair participation). Cluster development initiatives can support both SME export development and SME-FDI linkages.

- *Strengthen the gender, environment and health (e.g. HIV/AIDS, malaria) dimensions of SME development.* Gender, environment, and, as required, health issues (*e.g.* HIV/AIDS) should be mainstreamed into private sector/SME strategies. Critical issues such as women's access to collateral and property rights, education and training may need to be targeted with specific initiatives. Sustainable management of resources and the environment (*e.g.* in sectors such as agriculture, fisheries, tourism), and accelerating loss of economically active labour force due to prevalence of HIV/AIDS and other diseases such as malaria should also be included in SME strategies, as appropriate.

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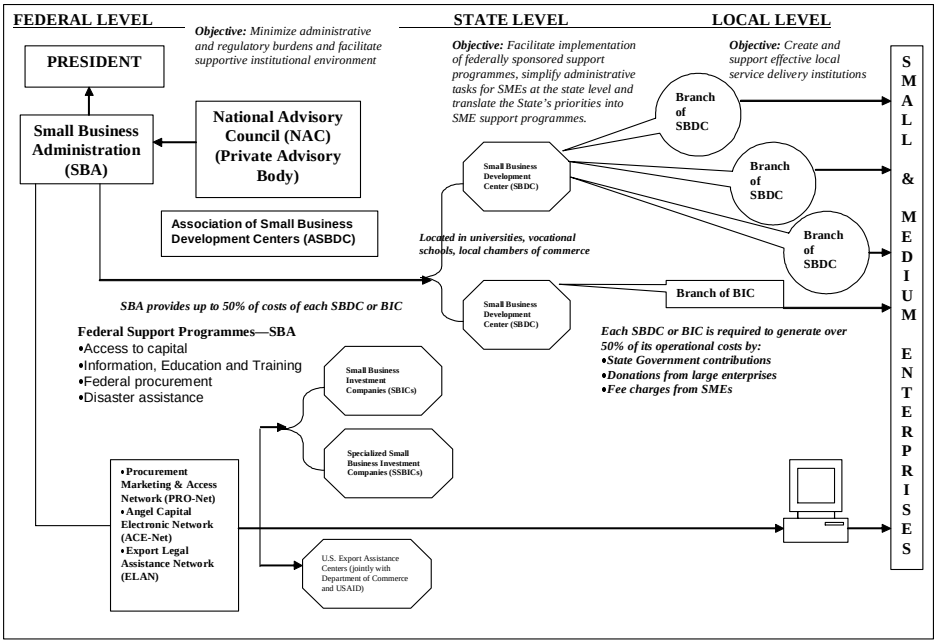
- *Enhance policy coherence at regional, national and international level and actively manage aid effectiveness* by 1) joined-up government nationally, 2) country-based and international donor coordination and pooling of technical and financial resources at appropriate levels, and by 3) complementing official development assistance (ODA) made available to transition and developing countries for capacity building in trade and investment with appropriate market access.

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ANNEX A. INSTITUTIONAL SUPPORT STRUCTURES FOR SMES

Figure A.1. SME Institutional Support Structures (USA and the Philippines)

Institutional Structure - SME Development in the USA



Institutional Structure - SME Development in the Philippines

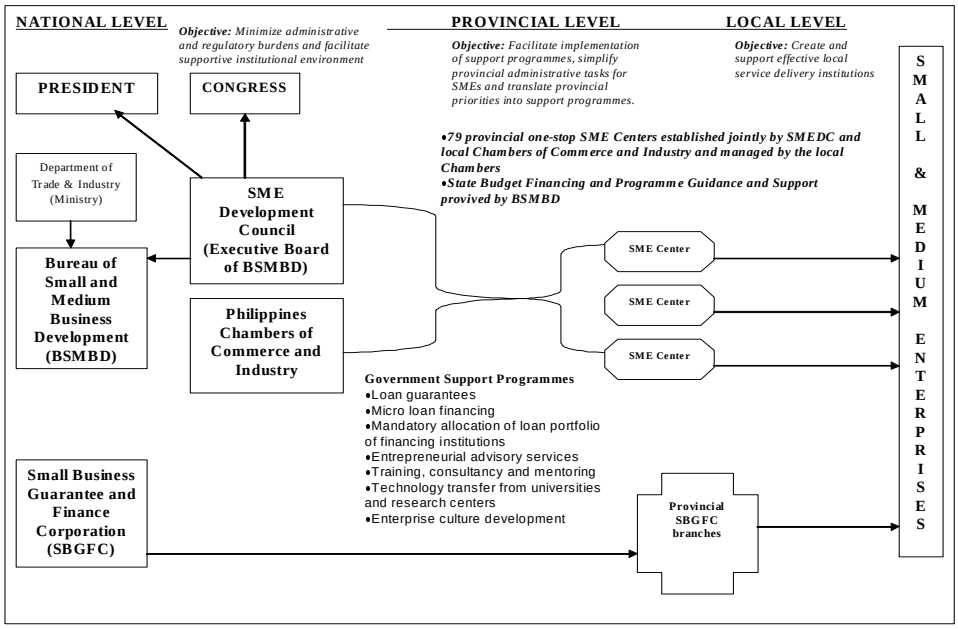
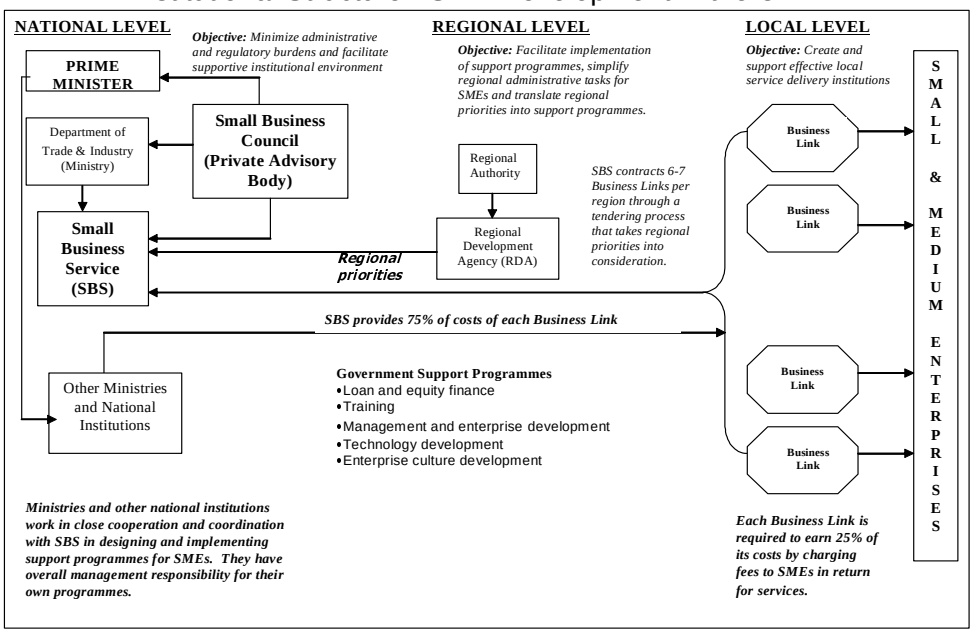
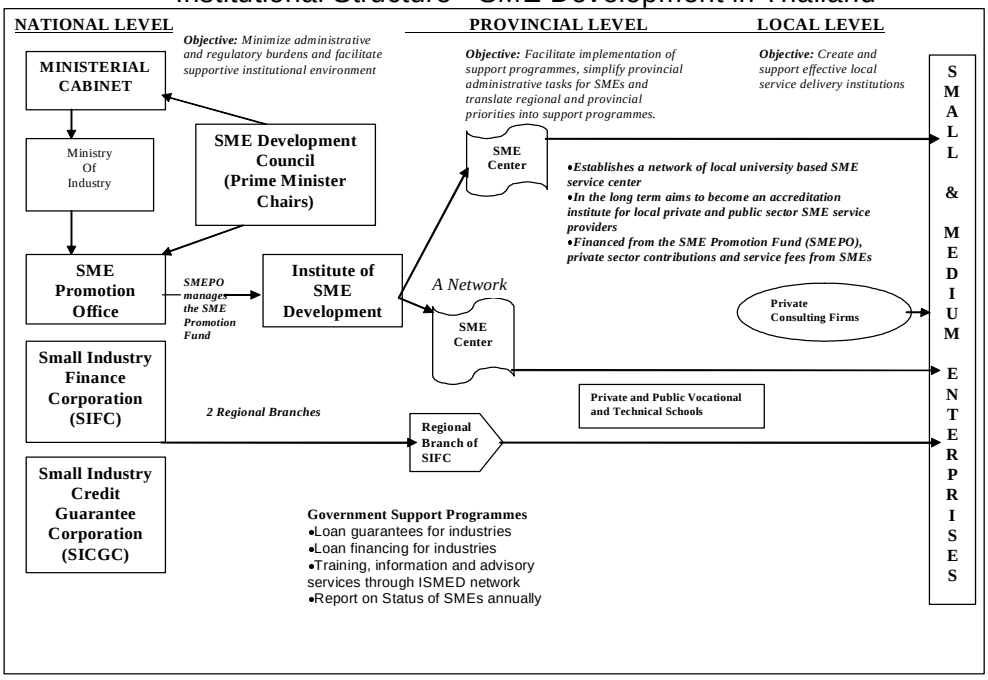


Figure A.2. SME Institutional Support Structures (UK and Thailand)

Institutional Structure - SME Development in the UK



Institutional Structure - SME Development in Thailand



Source: Tas, Nilgün (2002): Institutional structures reflect situation as of 2000-2001.

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Part III

DAC Peer Review of Japan

12 December 2003

Abstract: This review contains the Main Findings and Recommendations of the Development Assistance Committee and the report of the Secretariat. It was prepared with examiners from the United States and the European Commission for the Peer Review meeting on 12 December 2003. The principle issues covered were: develop a government-wide approach to the objectives of development co-operation, especially for poverty reduction; build broad based public support for continued ODA growth; strive to shape budget in line with ODA Charter priorities; make a policy statement on policy coherence for development and enhance government capacity to analyse these issues; move away from an instrument-based co-operation system to one that is country-based, including greater emphasis on operational decentralisation of aid; increase number and quality of development staff; identify concrete measures to further untie aid. This report is published on the authority of the Secretary-General of the OECD.

Acknowledgements: This paper has been prepared by Kaori Miyamoto, Sean Conlin and James Hradsky of the Development Co-operation Directorate's Review and Evaluation Division, with the assistance of Shiho Baba, Sayoko Uesu, Naomichi Murooka, Chihiro Fujita, Ruriko Minami, Sayuri Shirai and Lyndsay McLean-Hilker. Any comments or queries should be addressed to <dac.contact@oecd.org>.

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The Peer Review Process

The DAC conducts periodic reviews of the individual development co-operation efforts of DAC members. The policies and efforts of each member are critically examined approximately once every four years. Five or six programmes are examined annually. The OECD's Development Co-operation Directorate (DCD) provides analytical support and is responsible for developing and maintaining the conceptual framework within which the Peer Reviews are undertaken.

The Peer Review is prepared by a team, consisting of representatives of the Secretariat working with officials from two DAC members who are designated as "examiners". The country under review provides a memorandum setting out the main developments in its policies and programmes. Then the Secretariat and the examiners visit the capital to interview officials, parliamentarians, as well as civil society and NGO representatives of the donor country to obtain a first-hand insight into current issues surrounding the development co-operation efforts of the member concerned. Field visits assess how members are implementing the major DAC policies, principles and concerns, and review operations in recipient countries, particularly with regard to poverty reduction, sustainability, gender equality and other aspects of participatory development, and local aid co-ordination. A recent innovation is to organise "joint assessments", in which the activities of several members are reviewed in a single field mission.

The Secretariat then prepares a draft report on the member's development co-operation which is the basis for the DAC review meeting at the OECD. At this meeting senior officials from the member under review respond to questions posed by DAC members led by the examiners. These questions are formulated by the Secretariat in association with the examiners. The main discussion points and operational policy recommendations emerging from the review meeting are set out in the Main Findings and Recommendations section of the report.

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LIST OF ACRONYMS

ADB	Asian Development Bank
AMS	Aggregate measure of support
APEC	Asia-Pacific Economic Co-operation
APIC	Association for the Promotion of International Co-operation
ASEAN	Association of South East Asian Nations
BSS	Basic Social Services
CAP	Country Assistance Programme
CPRGS	Comprehensive Poverty Reduction and Growth Strategy
DAC	Development Assistance Committee
EC	European Community
ECB	Economic Co-operation Bureau
FDI	Foreign direct investment
FTA	Free Trade Agreements
GNP	Gross national product
GSP	Generalised System of Preferences
HIPCs	Heavily indebted poor countries
HLM	[DAC] High Level Meeting
IDS	International Development Strategy
IFIs	International financial institutions
IMF	International Monetary Fund
JANIC	Japanese NGO Centre for International Co-operation
JATAN	Japan Tropical Forest Action Network
JBIC	Japan Bank for International Cooperation
JCCI	Japan Chamber of Commerce and Industry
JETRO	Japan External Trade Organization
JEXIM	Export-Import Bank of Japan
JICA	Japan International Cooperation Agency
LDCs	Least developed countries
MAFF	Ministry of Agriculture, Forestry and Fisheries
MDBs	Multilateral Development Banks
MDGs	Millennium Development Goals
METI	Ministry of Economy, Trade and Industry

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MOF	Ministry of Finance
MOFA	Ministry of Foreign Affairs
NEXI	Nippon Export and Investment Insurance
NGOs	Non-governmental organisations
ODA	Official development assistance
OECF	Overseas Economic Co-operation Fund
OECO	Overseas Economic Co-operation Operations
OOF	Other Official Flow
PRSPs	Poverty Reduction Strategy Papers
PSE	Producer Support Estimate
TICAD	Tokyo International Conference on African Development
UN	United Nations
USAID	United States Agency for International Development
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNHCR	United Nations High Commission for Refugees
UNICEF	United Nations Children's Fund
UNIDO	United Nations Industrial Development Organization
WFP	World Food Programme
WHO	World Health Organization
WIPO	World Intellectual Property Organization
WSSD	World Summit on Sustainable Development
WTO	World Trade Organization

Exchange rates (JPY per USD) were:

1999	**2000**	**2001**	**2002**	**2003**
113.9	107.8	121.5	125.2	120

Signs used:

()	Secretariat estimate in whole or part
-	Nil
0.0	Negligible
. .	Not available
...	Not available separately but included in total
n.a.	Not applicable
P	Provisional

Slight discrepancies in totals are due to rounding

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Japan's Aid at a glance

JAPAN

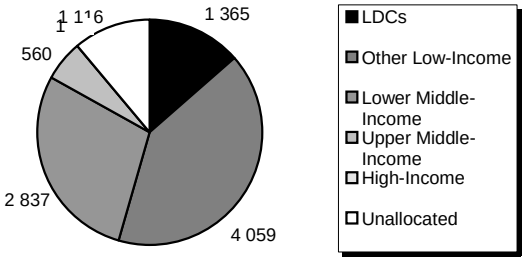
Gross Bilateral ODA, 2001-02 average, unless otherwise shown

Net ODA	2001	2002	Change 2001/02
Current (USD m)	9 847	9 283	-5.7%
Constant (2001 USD m)	9 847	9 732	-1.2%
In Yen (billion)	1 196	1 162	-2.9%
ODA/GNI	0.23%	0.23%	
Bilateral share	76%	72%	
Net Official Aid (OA)			
Current (USD m)	84	99	17.8%

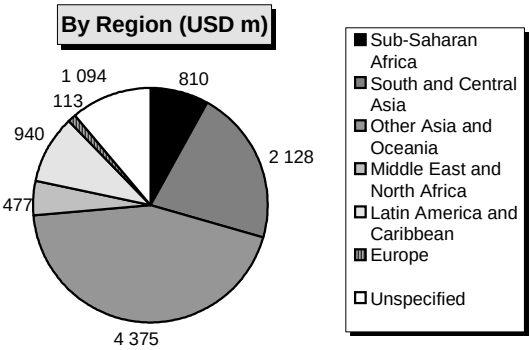
Top Ten Recipients of Gross ODA/OA (USD million)	
1 China	1 202
2 India	841
3 Thailand	758
4 Indonesia	748
5 Philippines	666
6 Viet Nam	429
7 Bangladesh	309
8 Pakistan	256
9 Sri Lanka	244
10 Brazil	171

By Income Group (USD m)

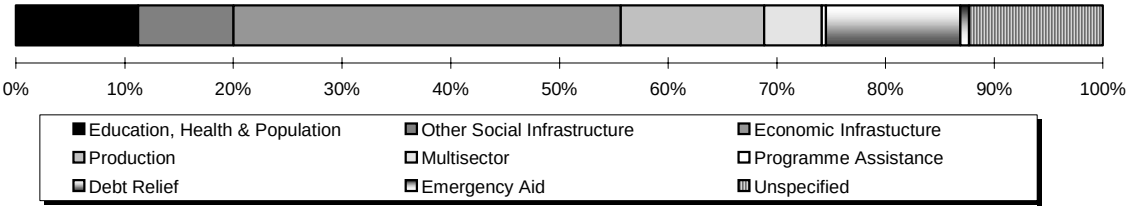
Clockwise from top



By Region (USD m)



By Sector



Source: OECD

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DAC'S MAIN FINDINGS AND RECOMMENDATIONS

New developments, overall strategy, and the public

Japan's development co-operation programme has undergone major reforms and significant restructuring since the last Peer Review in 1999. Most importantly, its Official Development Assistance (ODA) Charter was revised to reflect changed domestic and international circumstances. In addition, the legal status of the Japan International Cooperation Agency (JICA) was changed in 2003 to make it more autonomous. The former Overseas Economic Cooperation Fund (OECF) and the Export-Import Bank of Japan (JEXIM) merged into the Japan Bank for International Cooperation (JBIC) in 1999. Also, the Ministry of Foreign Affairs (MOFA) has become the *de jure* co-ordinating body for the diverse implementing institutions of ODA. In the international arena, Japan has played a leading role in fostering new initiatives and in hosting major conferences on development issues.

The ODA Charter, revised in 2003 from the 1992 version, forms the policy basis of Japanese development co-operation. It proposes that the ultimate objectives of ODA are "to contribute to the peace and development of the international community, and thereby to help ensure Japan's own security and prosperity". For Japan, as for other DAC members, ODA is an integral part of its foreign policy. As such, it is important that narrower national interests do not over-ride the primary development objective of ODA.

Poverty reduction is listed in the Charter as one of four priority ODA issues. In practice, Japan needs to more fully mainstream poverty reduction and other cross-cutting issues throughout its development co-operation system though poverty reduction is addressed through interventions in various sectors. Past emphasis on economic growth has not always taken full account of the poverty reduction dimension, and Japan, with its experience, could usefully contribute to better document the relationship between economic growth and poverty reduction. While the ODA Charter recognises the common development goals of the international community, the achievement of the MDGs could be further elaborated in a statement of strategy.

There is clearly a sign of aid fatigue among the Japanese public. Although in part due to Japan's weak economic situation, the public is also becoming critical regarding the effectiveness of the aid programme and the commercial sector has become less supportive of aid. Simultaneously, the public is supportive of humanitarian efforts and responding to crises. While substantial effort is made to disseminate official development information, the public is only marginally influenced by it, is generally unfamiliar with ODA issues, and has misconceptions concerning the bilateral aid programme. Therefore, a recent decision to incorporate development education in school curriculums is encouraging as a way of broadening support. With better understanding of development issues from early formative years, the students will hopefully become the future supporters and participants of Japanese and international development co-operation efforts.

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Recommendations

- In implementing the ODA Charter, Japan should highlight that the primary objective of ODA is for the development of the recipient country, and should ensure that narrower national interests do not over-ride this objective.

- Japan should develop a government-wide approach to mainstream cross-cutting issues, rather than treat them as separate sectors, particularly concerning poverty reduction as part of achieving the Millennium Development Goals.

Aid volume and allocations

In 2002, Japan's net ODA volume of USD 9.3 billion was the second largest among the DAC countries. In 2001, Japan conceded its status as the largest bilateral donor to the United States, a position it had held for a decade. However, Japan recorded an ODA/GNI ratio of only 0.23%. The continuing recession has had an effect on the gradually declining trend of ODA funds. At the 2002 Monterrey Conference, Japan was one of the few DAC members which was unable to commit to maintain or increase ODA. With loan repayments from developing countries steadily increasing, Japan may have to increase the ODA budget so as to maintain current levels of net flows.

A prominent feature of Japanese bilateral aid is the significant proportion of loans, representing 55% of total bilateral ODA in 2002. This is easily the most extensive use of loans of any DAC country. Japan's reason for focusing on loans is mostly due to its own experience of having had borrowed credit from the World Bank for its post-war reconstruction. The ODA loans are normally untied, with the recent exception of a short-term, tied Special Yen Loan facility (1999-2002) that was set up to help countries affected during the Asian crisis. As a result of providing large amounts of loans, Japan is by far the largest bilateral creditor to developing countries, including Least Developed Countries (LDCs). In response to the Heavily Indebted Poor Countries (HIPC) Initiative and other international efforts, Japan's involvement with debt relief is rising. As Japan continues to disburse ODA loans to low-income highly indebted countries, more attention should be given to debt sustainability issues.

Japan has a clear policy on priority attribution of ODA to Asia and some 74% of bilateral ODA is disbursed to the region. The top ten recipients of Japanese ODA in 2001-2002 were China, India, Thailand, Indonesia, Philippines, Viet Nam, Bangladesh, Pakistan, Sri Lanka, and Brazil. Six are Low Income Countries and the list includes the five countries with the most number of absolute poor. In addition, Japan is the largest donor in several African countries. This suggests that Japan could usefully clarify its policy on how it intends to focus on poor countries or the poor populations within countries.

Concerning sector allocations, only a small portion of Japanese resources in the social sector is actually directed towards Basic Social Services (BSS). As was noted in the 1999 Peer Review, Japan's allocation in the social sector tends to be directed to the tertiary levels, such as universities, research institutions, urban water systems or hospitals.

Recommendations

- Japan should make every effort to increase ODA levels as economic conditions improve, building broad-based public support to facilitate this.

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- Lessons learned from the provision of loans to indebted poor countries that resulted in large debt relief should be factored into future lending policies.

- The development of a clearer policy on how Japan intends to focus on poor countries or poor populations within countries should be considered.

- Japan should strive to achieve a more balanced sector portfolio in line with new ODA Charter directions, by focusing more investment in basic health and education services to reduce poverty.

Policy coherence

At the 2002 Ministerial Council Meeting, OECD Ministers recognized the need to bring greater coherence across a wide range of policies that impact on developing countries. Among the policies, trade and agricultural policy issues became the most urgent as a result of the Doha Development Agenda for negotiations at the WTO. Japan has promoted FDI into the Asian region, based on its view that economic growth is the main driver of development. The private sector role in FDI is facilitated by the Japanese government, using both ODA and non-ODA funding. The Japanese government is negotiating regional economic co-operation agreements and Free Trade Agreements, which are expected to be mutually beneficial to Japan and its partners. Japan is also carrying out capacity building activities, particularly in the APEC countries. Furthermore, JBIC has recently developed environmental guidelines for borrowers using ODA loans or export credits, which encourages coherence between the two instruments. At the same time, Japan needs to establish a system for monitoring compliance with codes of conduct by the private sector, covering social, environmental and governance issues.

Japan imports 60% (by calorific value) of its food and is the largest net food importer from developing countries. It does not provide export subsidies for agricultural products. Agricultural policies have addressed the decline of Japanese agriculture by promoting rural development, preserving the landscape and securing Japan's food supply, which are characterised as the "multifunctionality of agriculture." There are still import barriers to agricultural products, including high tariffs on rice, tariff escalation on processed foods; and other restrictions such as sanitary and phyto-sanitary procedures, and state management of certain agricultural products. Based on *Agricultural Policies in OECD countries: Monitoring and Evaluation* (OECD, 2002), Japan's support remains among the highest in the OECD countries and is dominated by the most production and trade distorting measures. These barriers and restrictions make access to the Japanese market difficult for developing and other countries. To address the problems of LDCs, however, Japan has proposed an initiative for enhancing the Generalized System of Preference scheme. It covers 2 287 duty-free and quota-free products from 47 LDCs, including 436 from agriculture, forestry and fisheries. At the same time, significant challenges of market access remain for some commodities that are excluded from the scheme, notably rice and sugar.

The ODA Charter and institutional arrangements for co-ordination among ODA related institutions provide opportunities for enhancing policy coherence, but there is a need for an explicit government-wide statement on policy coherence for development so that the public is made more aware of the issues. There is a risk of incoherence if officials promote domestic interests at the cost of development of developing countries. Japan appears to do relatively little analytical work on policy coherence for development issues (a notable exception is a research programme with the OECD on East Asia) and should give attention to this issue. In this respect, MOFA, given its co-ordinating role, could take leadership in enhancing the capacity of the Japanese system to analyse policy coherence issues. Rather than promoting particular interests, MOFA could facilitate discussions on policy

coherence for development, including the possible long term mutual benefits to Japan's consumers and taxpayers as well as developing countries.

Recommendations

- The government of Japan should make a policy statement on coherence for development and seek ways to educate the public on this issue.

- The Japanese government should enhance analytical capacity on policy coherence for development in order to improve its ability to take appropriate policy decisions.

- Japan should establish a system for monitoring the environmental, social and governance aspects of FDI and of regional economic co-operation agreements.

Aid management and implementation

Important initiatives for the reform of ODA operations began in 2002 and have led to a variety of new options for future Japanese development co-operation, including pilot work at the field level in Vietnam and Tanzania. The current Japanese ODA management system is actually a locally co-ordinated network of separate ODA administrations. MOFA now plays a core role within the ODA organisational hierarchy, over which it was accorded the *de jure* responsibility for co-ordination in 2001, in addition to its responsibilities for policy formulation and provision of grant aid. Of the two implementation agencies, JICA undertakes about half of Japanese technical co-operation. The other agency is JBIC, which was formed in 1999 as the result of a merger of the former OECF and JEXIM. JBIC constructed an administrative firewall between the two functions of ODA loans and export credits, the administrative units for which report separately and maintain different sets of procedures. The Ministry of Finance also has an ODA role, mainly by passing funds to JBIC and through its liaison responsibilities with the IFIs. In addition, there are about 10 different ministries responsible for ODA operations, most of which is technical co-operation.

Within MOFA, the Economic Cooperation Bureau has responsibilities for ODA policy formulation, inter-agency co-ordination, and grant aid management. Bureau operations are largely organised around instruments (operation of grants and supervision of loans and technical co-operation) rather than on a country basis, which raises the issue of how to relate with the other geographic bureaus, the implementation agencies, and the field. The fact that Japan is now putting in place a country strategy and country-based team approach should help MOFA to move more rapidly to a more decentralised operational system. Also of particular interest to the future efficiency of Japanese ODA management is the division between grants and technical co-operation, both of which are so operationally related that the distinction between them often appears artificial. Operationally, the separate administration of MOFA grants and JICA technical co-operation can lead to transaction costs and difficulties in maintaining the linkage between strategy and implementation, not to mention confusion among development partners. To enhance system complementarity and synergy, the entire sequence of project planning and implementation of both grants and technical co-operation could be delegated to an experienced developmental agency like JICA. Such an arrangement would offer MOFA the advantages of ending its operational role and redistributing its limited resources toward the priority mandate of system co-ordination, strategy and policy development.

At the time of writing, Japan had a total staff level of 2 097 development professionals to manage its worldwide portfolio of USD 9 billion, an estimated 668 of whom were located in the field. Japan continues to be one of the more thinly-staffed systems among DAC members. Its overall human resource capacity is further reduced by the fact that MOFA development staff and those seconded by

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other ministries rapidly rotate out of development co-operation. As regards training, there is currently no requirement for specific experience or substantive formal development training for MOFA officials who work on development co-operation. MOFA is encouraged to consider establishing a career track in the "development" category, so as to attract and maintain high level staff that will be needed to carry out the current Ministry mandate in strategic co-ordination and policy.

Japan's highly centralised administration and the special interests of the different ODA institutions have created bureaucratic obstacles to operational decentralisation. However, Japan is now slowly moving towards greater decentralisation through a new ODA Task Force team concept. The ODA Task Force is an all-Japan co-ordinating body in the field that can foster internal Japanese co-ordination around a common vision and build synergies among agencies dealing with grants, technical co-operation and loans. Japan is now testing in Vietnam and Tanzania the use of such an ODA field team to design the country strategy in a manner consistent with locally-owned national approaches, such as the PRSP. Nevertheless, Japan currently lacks a country-based budget approach, which would make its work more efficient and more easily understandable for its partners. It will be important to retain the current flexibility to respond to sudden needs. Although Japan continues to organise its programmes mainly on a project basis, it remains open to whatever modality seems to make the most sense, including sector programmes.

Concerning harmonisation policy, Japan is globally supportive of the harmonisation of its implementation procedures with other partners and has played a lead role in pilot loan harmonisation activities in Vietnam and elsewhere, and is Vice-chair of the DAC's Working Party on Aid Effectiveness. At the same time, the practice of tying ODA grants to Japanese primary contractors, despite the extensive use of non-Japanese sub-contractors, remains under discussion in the context of the 2001 DAC Recommendation on Untying ODA to the LDCs.

Recommendations

- Japan should consider moving away from an instrument based co-operation system to a more country based approach, as well as establishing country budget envelopes. Japan should replicate more broadly its decentralisation pilot efforts, such as that of Vietnam and Tanzania, with special emphasis on an effective use of a country-based, all-Japan team and strategy approach.

- The Ministry of Foreign Affairs should consider delegating most grant management to the Japan International Cooperation Agency and focusing its energies on strategy, policy development and system co-ordination.

- More development co-operation staff are needed across the system, particularly if decentralisation is to succeed. An integrated ODA personnel policy should be established that includes planning and analysis of development staff levels and skills.

- Japan should work with the DAC on identifying concrete measures to progressively untie the use of grant funds for primary contractors in the spirit of the Recommendation on untying ODA to the least-developed countries.

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CHAPTER 1

NEW DEVELOPMENTS AND OVERALL FRAMEWORK

New developments

Japan's development co-operation programme has undergone major reforms and significant restructuring since the last Peer Review in 1999 (see Annex A). Perhaps most importantly, its Official Development Assistance (ODA) Charter was revised to reflect changed domestic and international circumstances (see Annex B). In addition, the legal status of the Japan International Cooperation Agency (JICA) – which undertakes technical co-operation – was changed in October 2003 to make JICA more autonomous. The former Overseas Economic Co-operation Fund (OECF) – which manages the ODA loans – and the Export-Import Bank of Japan (JEXIM) were merged into the Japan Bank for International Cooperation (JBIC) in 1999. Other reforms include making the Ministry of Foreign Affairs (MOFA) the *de jure* co-ordinating body for the diverse implementing institutions of ODA; strengthening other co-ordination mechanisms; establishing decentralisation, and increasing transparency by facilitating participation of the public and non-governmental organisations (see Chapters 5 and 6).

In the international arena since 1999, Japan has played a leading role in fostering new initiatives and in hosting major conferences on development issues, including the initiatives for Human Security, and Consolidation for Peace (see Chapter 3), the Initiative for Development in East Asia – IDEA – and the Tokyo International Conference for African Development – TICAD (see Chapter 2). Japan's pro-activeness in organising these forums has been welcomed by all members of the Development Assistance Committee (DAC).

Japan's aid reforms, particularly revision of its ODA Charter, reflect, in part, increasing public concern regarding the efficient and effective use of aid, especially in light of reports of misuse of MOFA resources; the economic recession; the size of the fiscal deficit; and rising unemployment. All of these factors led to a decline in public support for ODA, as well as specific reductions in the ODA budget. As a result, in 2001, for the first time since 1992, Japan lost its position as the largest bilateral donor, in volume terms, and is now the second largest donor after the United States. Japan was also one of the few DAC members that did not pledge to maintain or increase ODA at the 2002 International Conference on Financing for Development in Monterrey. On the other hand, Foreign Direct Investment (FDI) has picked up, particularly to East Asia, indirectly due to the tied Special Yen Loan Facility (see Chapter 2).

Overall aid administration structure

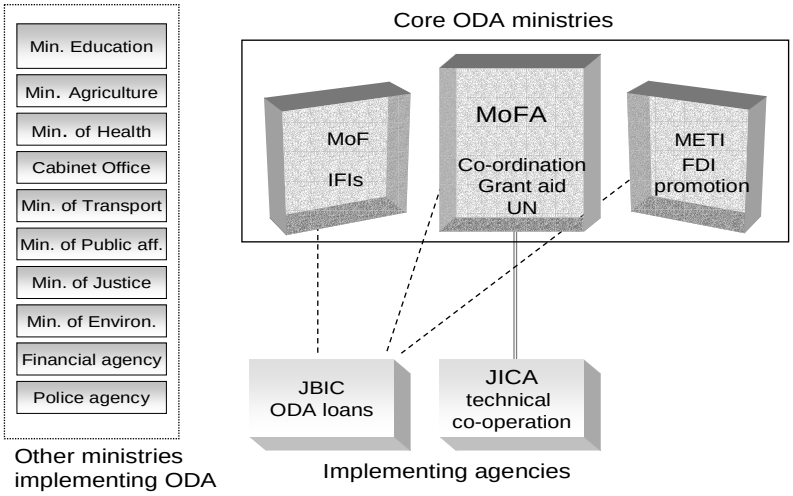
The overall structure of Japan's ODA administration has changed little since the last Review.[1] MOFA now has a *de jure* as well as *de facto* co-ordinating role, although it consults with the Ministry of Finance (MOF) and Ministry of Economy and Trade and Industry (METI) on ODA loans. MOFA remains the supervisory ministry for JICA and co-ordinates the ODA-related efforts of at least ten

1. Except the Economic Planning Agency was merged into the new Cabinet Office.

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other ministries and agencies that implement ODA programmes (see Figure 1). In that respect, Japan's aid system remains one of the most dispersed and complex among DAC members, which presents clear challenges for co-ordination. Japan also maintains separate programmes for ODA loans, grants and technical co-operation. Some options regarding rethinking of roles within the ODA architecture are explored in this Review (see Chapters 3 and 5).

Figure 1. Japanese co-operation system



Source: OECD

The new ODA charter

In August 2003, Japan revised and updated the 1992 version of its ODA Charter. Although it was not approved by the Diet (Parliament), and thus does not have the force of law, the Charter was approved by the Cabinet, and thus forms the policy basis of Japanese ODA. The objective of the revision was to address new development challenges as well as to strengthen support for ODA and to make it more strategic, efficient and transparent. The year-long revision process was participatory and consultative with aid agencies, academia, civil society, and ordinary citizens involved. An ODA Comprehensive Strategy Board[2] was established and formal comments were submitted by the Liberal Democratic Party, Japan Federation of Economic Organisations (Keidanren) and non-governmental organisations (NGO) groups.

In the Charter, the objectives of ODA are stated as "to contribute to the peace and development of the international community, and thereby to help ensure Japan's own security and prosperity". Other benefits to Japan through provision of ODA are mentioned as "promoting the welfare of its people", "promoting friendly relations and people-to-people exchanges with other countries", "strengthening Japan's standing in the international area", and "gaining sympathy and support from the international community for Japan's position". For Japan, as for other DAC

2. Established in June 2002, the Board's mandate is to strengthen MOFA's role in co-ordinating related agencies and to ensure further transparency in ODA operations. It consists of 18 members, including the Minister of Foreign Affairs as the chairperson and 17 members with representatives from academia, NGOs, press and the development and financial sectors.

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members, ODA is an integral part of its foreign policy. Asia will remain the priority region since it has "a major impact on Japan's stability and prosperity". Although the term "national interest" is not used in the Charter, this concept has so far featured prominently in the Japanese aid programme, not necessarily in terms of direct economic benefits, but also through sharing Japanese experience and expertise, raising visibility of Japanese presence ("showing Japan's face"), as well as ensuring national environmental protection and security.

There is a perception that Japan has at times used its development assistance also for various purposes other than those directly related to development. This should be seen in the context of the DAC definition of ODA – which Japan has agreed to – stipulating that the primary objective of ODA must be for the development of the recipient country. Moreover, gaining benefit for Japan does not appear to reflect the general sentiment of the Japanese public which considers that the objective of ODA is for the benefit of developing countries (see Box 1). All DAC governments, including Japan, need to be vigilant that narrower national interests do not supersede the objective of development of recipient countries.

The Charter's principle for ODA implementation, which includes environmental conservation, non-military use, attention to recipient countries' military activities, and democracy and human rights, remains basically the same as the 1992 version. At the same time, the last Charter has been applied in such a way as to allow the provision of aid to nuclear powers such as India and Pakistan (suspended in 1998 when both countries carried out nuclear weapons tests), one-party states such as China and Vietnam, and to military regimes such as Myanmar (though it is understood that Japan stopped funding new ODA projects in Myanmar in May 2003, in view of that country's human rights situation). In 2001-02, over a third of allocable bilateral gross ODA was disbursed to these countries. How the new Charter would affect funding levels to these countries remains to be seen.

Basic policies in the Charter introduce new concepts such as "human security" which focuses on the protection and empowerment of individuals, and "fairness", which addresses gender issues and the gap between the rich and the poor. Japan has hitherto been relatively reticent in applying these two concepts in its aid programme, and their future mainstreaming will be of interest. The new Charter also expresses more willingness to collaborate with the international community, which includes multilateral organisations, other donors, NGOs, and the private sector. While Japan's position towards self-help efforts and respect for ownership through request-based proposals remains the same, the new Charter states the need for more active engagement in policy consultation before requests are made by developing countries. This may somewhat change the current approach of deciding on projects predominantly based on the request of the recipient country (see Chapter 3).

The Charter also calls for active engagement in policy dialogue; strengthening field missions; increased participation of civil society and the public; increased development expertise; promotion of intellectual assets in development; enhancement of development education; and transparency. These are positive directions which could improve the quality of Japanese aid significantly. While the Charter promotes enhanced synergies and collaboration within the aid system (termed "coherent"), the term "coherent" here does not mean "policy coherence for development" of non-aid policies. Japan could do more in this area, starting with a clear policy statement on policy coherence for development, establishment of a system to enhance analytical capacity on coherence, and the creation of a mechanism to monitor environmental, social and governance guidelines in FDI (see Chapter 4).

In the Charter, poverty reduction is listed as one of four priority issues, the others being sustainable growth, global issues, and peace-building. Here, poverty reduction is not clearly stated as a cross-cutting issue but would be primarily addressed through direct forms of intervention such as education, health, water, sanitation, and agriculture. While mentioning that sustainable economic

growth is indispensable for realising poverty reduction, the Charter treats sustainable growth as an independent priority issue in itself, not necessarily leading to the objective of poverty reduction.

In practice, Japan has yet to develop a system to mainstream poverty reduction in development co-operation, although its treatment varies widely depending on the three main aid implementing organisations (see Chapter 3) and there is some exchange of views among them. Japanese officials state that economic growth is an important means for poverty reduction. Past emphasis on economic growth has not always taken full account of the poverty reduction dimension, and Japan could usefully contribute to better documenting the relationship between economic growth and poverty reduction. Japan's promotion of economic growth is important in the international debate, but its links with poverty reduction could be clearer. While the ODA Charter recognises the common development goals of the international community, the achievement of the Millennium Development Goals could be further elaborated in a statement of strategy.

The Diet and other advisory bodies

Although legal, the Japanese Diet's influence over aid issues is generally limited to the approval of the ODA general budget, there has been growing political involvement in ODA matters. The Diet is increasingly raising questions, especially after recent revelations of misuse of funds by MOFA officials and certain politicians. It has also become more critical about Japan's substantial aid to China (see Chapter 2), especially in view of the latter's expanding economy and its effect on Japanese industries. In addition, the Diet requires MOF to consult on issues such as contributions to the Multilateral Development Banks (MDBs). The Cabinet also approves the list of ODA projects every few months, although this is more or less a formality.

On a more selective basis, the Diet Committee on Foreign Affairs and Defence which handles ODA issues, has promoted, for example, the delivery of medical supplies by NGOs to Kurdish refugees and the dispatch of the Self Defence Force to Iraq for humanitarian aid. The Liberal Democratic Party's ODA Reform Working Team also submitted a recommendation concerning the new ODA Charter before finalisation. Furthermore, some politicians pressure MOFA to try and intervene in project selection for their visiting or favourite countries or sectors. Special lobby groups such as the construction industry also try to mobilise Diet members to act on their behalf.

Japan has created several ad hoc groups consisting of a wide range of representatives from aid agencies, academia, mass media, NGOs, and the private sector to advise on various ODA matters. Examples include the Second Consultative Committee on ODA Reform[3] and the ODA Comprehensive Strategy Board. Other specialised advisory groups include those on ODA Country Assistance Strategy, which reviews Japan's country strategies, and on ODA Grant Assistance, which reviews all grant proposals before submission to the Cabinet. There are many positive aspects to wide participation and transparency, including wider public understanding of ODA matters and increased accountability. On the downside, the burden of managing the consultative process by the already understaffed aid agencies (see Chapter 5) cannot be overlooked. Furthermore, with such wide representation, there may be a tendency for discussions to result in "constructive ambiguity".

3. To follow up the discussion held by the First Consultative Committee of ODA Reform, MOFA established a second external committee where intellectuals discuss necessary changes in ODA for better use of limited resources. The committee is composed of academics, journalists and financial specialists.

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Public opinion

There is clearly a sign of aid fatigue among the Japanese population. According to the opinion polls of the Cabinet Office, which have been conducted annually since 1977, there is a noticeable decline in the proportion of people who believe that ODA should be augmented (41% in 1991 to 19% in 2002) and an equally clear rise among those who feel that ODA should be reduced (8% to 24%) or even abolished (1% to 5%). Although the proportion of those who responded that "the current ODA level should be maintained" has remained relatively constant at around 45%, the trend regarding the two extremes is worrisome. There was a slight increase in ODA support in 2001, attributable to the post September 11 effect, but it was not sustained in 2002.

Among those who preferred reduction or abolition of ODA, 75% attributed their choice to the deteriorated economic situation in Japan[4] and 44% mentioned fiscal deficit - both slight increases compared to 2001. However, there were substantial increases in those who cited lack of transparency (27% in 2001 to 41% in 2002), unsatisfactory achievements (24% to 31%) and inefficiency (11% to 17%), which indicate that the public is becoming disappointed and critical regarding the effectiveness of the aid programme. At the same time, the commercial sector has become less supportive of aid. On the other hand, another survey shows that the public is supportive of humanitarian efforts and responding to crises (see Box 1), which indicates a possible disconnect with the ODA Charter. Surveys by the Ministry of Agriculture, Forestry, and Fisheries (MAFF) also show the public's increasing interest in environmental issues.

Box 1. APIC Opinion Survey

The Japanese Association of Promotion for International Co-operation (APIC) carried out a survey on ODA in 2002, which showed that the public seemed to be more humanitarian minded and less concerned with national interests. Of those who were positive about ODA, only 15% (see footnote 4) responded that ODA should be for Japan's benefit - to enhance friendship with developing countries, increase understanding of Japan by the developing countries, or secure food and energy. More than 56% considered it necessary for humanitarian reasons, 50% to help the economic development of developing countries, 31% to help world peace, and 15% as an obligation of an economically powerful country. Regarding regional preferences, 43% responded Asia and 24% Africa - compared to the actual disbursement of bilateral aid (75% Asia and 10% Africa). Preference for Africa is most likely due to humanitarian reasons.

The survey also showed that efforts on development information did not seem to be wide-reaching. Fifty-five per cent of respondents answered that they were not familiar with ODA whereas 44% were. Even those who were familiar had the misconception that ODA was mostly about the Japan Overseas Co-operation Volunteers, supporting NGOs, as well as activities in basic health and education, which are minor components of the Japanese aid programme. Generally, the public obtains information on ODA from the media, particularly TV programmes and newspapers.

4. Respondents were allowed to choose multiple answers.

Development information and education

Numerous official aid organisations continue to make substantial efforts in development education. APIC, which is subsidised by MOFA, runs an information centre to provide materials on development co-operation in Tokyo and jointly with 40 local administrations throughout Japan. MOFA's annual ODA report also remains the most comprehensive among the DAC members[5]. At the same time, APIC's survey shows that the public is generally unfamiliar with ODA issues, has misconceptions of the bilateral aid programme, and does not usually obtain information on development issues from these public materials (see Box 1). Japan could carry out a comprehensive assessment of its development information activities so as to enhance support and appropriate understanding of ODA by the public.

Japan does not have a long-standing history of private humanitarian or philanthropic aid towards other countries (in comparison with its 50-year history of official development assistance). The NGO sector in Japan is young and small (see Chapter 5). Strong ODA supporters were hitherto mostly in the commercial sector, which started to wane as Japan untied its aid in the 1980s. Some critics say that since then, the government has not really managed to replace this support by capturing the wider public's interest in ODA matters.[6]

On the other hand, in the last decade, many academic courses in development co-operation at undergraduate and post-graduate levels have been established. This movement has been a response partially to the growing interest in development issues by Japanese adolescents who grew up in the relatively affluent period of the 1970s to the 90s that led them to broaden their views on the less fortunate parts of the world. The Kobe earthquake of 1995 is also said to have raised the interest of the youth in helping others in crisis and need. A major progress is Japan's decision to incorporate development education in elementary to junior high school curriculums, which was a recommendation by the Second Consultative Committee on ODA Reform. With better understanding of development and global issues from early formative years, it is hoped the students will become the future supporters and participants of Japanese and international development co-operation efforts.

Future considerations

- In implementing the ODA Charter, Japan should highlight that the primary objective of ODA is the development of the recipient country and ensure that narrower national interests do not override this objective.

- Japan could consider setting out a plan to inform the Japanese public of the policy and operational implications of the new ODA Charter, especially in light of the interest in increased aid effectiveness.

- Japan should assess its development information activities so as to enhance support and appropriate understanding of ODA by the public.

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5. It serves as a best practice report that includes a wide range of data and topics from ODA general budget and disbursement details, descriptions of activities in regions, countries, and sectors, chronology of events, various DAC data, as well as ODA descriptions of other DAC Members. JICA and JBIC also publish various reports and informational materials, respectively.

6. Mitsuya Araki, "Who will Cheer for ODA?: Thoughts on the ODA Support Base for the Future" (In Japanese. OECD translation of title), International Development Journal, February 2003, p 6-7.

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CHAPTER 2

AID VOLUME, CHANNELS AND DISTRIBUTION

Official development assistance volume and the economic situation

In 2002, Japan's net ODA volume was USD 9.3 billion and ranked second among the 22 DAC member countries. Since the previous Peer Review, Japan conceded to the US its status in 2001 as the largest bilateral donor, a position it had held since 1992. While Japan's net ODA accounted for 25% of total DAC ODA in 2000 (the highest figure), this proportion is now reduced to 16%. In terms of ODA/GNI ratio, Japan recorded 0.23% and was the 5th lowest among the DAC countries (see Figure C-1). In terms of per capita ODA contribution, however, with USD 97, Japan ranked 7th and was the highest among the G7 countries in 2000-01.

The continuing recession, following the burst of the economic bubble in 1990, has had an effect on the gradually declining trend of the ODA budget and net ODA disbursement. The difficult economic situation is inevitably causing challenges to organisational resources as well, such as administrative costs, staffing, and decentralisation. The exception to the decline is between 1997 and 2000 when Japan increased ODA in order to respond to the problems of the Asian Crisis (see graph in Table III-1). The short-term increase, however, was somewhat offset in 2001 when the Asian Development Bank (ADB) returned to Japan approximately USD 3 billion of the unutilised special fund[7] that Japan had contributed from 1999, which was deducted from ODA flows.

Although Japan subscribed in 1970 to the UN target of 0.7% ODA/GNI ratio, this has long been put aside. The highest that Japan has ever achieved was 0.34% in 1984. At the 2002 Monterrey Conference, Japan was one of the few DAC members which did not pledge to maintain or increase ODA volume and the ODA/GNI ratio. With loan repayments steadily increasing from developing countries and amounting to USD 2.9 billion in 2002, Japan may have to further increase the ODA budget to maintain current net ODA disbursement levels. At present, there is no visible evidence to suggest that ODA budgets take into consideration expected repayment amounts from developing countries and the government does not disclose repayment projections to the public. According to MOFA's projections regarding Japan's ODA in 2006, Japan's ODA/GNI ratio may drop to between 0.14% and 0.21% and its ranking in ODA volume may become fourth or fifth among the DAC members.[8] According to the aforementioned APIC opinion survey (see Box 1), the public regards the

7. Asian Currency Crisis Support Facility.

8. Under the scenario of (a) no increase or decrease; (b) 5% decrease annually; or (c) 10% decrease annually, the ODA/GNI ratio could be: (a) 0.21%; (b) 0.17%, or (c) 0.14% in 2006. Assuming that other DAC members keep their commitments of ODA increases made in various forums, MOFA projects that Japan's ranking in terms of ODA volume will become fourth amongst the DAC with scenarios (a) and (b) and fifth under (c). Source: MOFA paper presented to the ODA Comprehensive Strategy Board.

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current ODA/GNI level and ranking to be appropriate and does not see the necessity of Japan being a leading donor like the US and certain European countries.[9]

Japan's economy is still in a serious deflationary state with recovery being narrowly based on exports and inventory correction. There is also continuing weakness in the labour market, which is restraining consumption growth. However, the economy recovered from negative growth by the end of 2002, and market consensus suggests that the growth rate could reach 2% for 2003. Furthermore, although the fiscal budget was cut 4.4 % between 2000 and 2002 in order to reduce the current large deficit, the 2003 budget remained the same as 2002. Therefore, given the state of its economy and fiscal situation, at least maintaining the current ODA level seems possible.

Bilateral aid

Loans

A prominent feature of Japanese bilateral aid is its large proportion of loans, which are concessional and administered by JBIC. In 2002, of bilateral ODA, the distribution was as follows: 55% loans[10] (see Table C-2, although the percentages in the table are of total ODA and not of bilateral ODA), 19% technical co-operation, and 27% non-technical co-operation grants. Japan's proportion of loans was by far the largest among DAC Member countries – the loan share in Total DAC ODA was 19%, and would have been 8% without Japan. Although there has not been a noticeable proportional decrease for Japan since the last Review (56% in 1998), over the long run, it has decreased from a peak of 82% in 1975. The number of loan recipient countries has also decreased from a peak of 62 countries in 1989 to 52 countries in 2002. The proportion of loans in bilateral ODA differs according to geographical regions, for example, Asia had 71% loans while Sub-Sahara Africa (SSA) had only 10% in 2001. SSA had a higher proportion of loans peaking at 81% of bilateral ODA in 1975. There are also differences in loan provision according to income levels. In 2001, the share of loans in bilateral ODA was: 75% to Other Low Income Countries, 57% to Middle Income Countries; 10% to the Least Developed Countries (LDCs) and 0% to High Income Countries. JBIC has ceased providing loans to African LDCs since 1997.

Japan's reasons for focusing on loans is mostly due to its own experience of having had borrowed credit from the World Bank for its post-war reconstruction. It considers that loans promote "self-help efforts" that respect more ownership of the recipient country as opposed to grants that have no obligation of repayment. Loans could also finance large scale infrastructure projects which would be more difficult to justify with grants. Furthermore, although the loans are substantially concessional (over 70% grant element), they would be of less burden to the Japanese tax payers. Loan projects also tend to comply with the priorities of the recipient governments as they are selected more carefully. For example, in Indonesia, the Parliament has to approve loans whereas it does not for grants.

The ODA loans are normally untied. This is to be complimented since untied aid is generally considered to be more cost effective and allows for greater partner country ownership and for harmonisation of donor procedures. However, Japan established a short-term tied Special Yen Loan facility from 1999 to 2002 which aimed to help the countries that were affected by the Asian crisis and

9. Asked what they thought of Japan's ODA/GNI ratio of 0.23% in 2001 and the fact that Japan was 18th out of 22 industrialised country donors, the responses were: 48% appropriate, 19% too low, 10% should be lower, and 23% didn't know. Asked what ranking Japan should have in terms of ODA volume, 31% responded 4th, 17% 3rd, 12% 1st and 35% didn't know.

10. Called "non-grant bilateral ODA".

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to simultaneously assist the ailing Japanese economy. They were used mainly for three priority areas: the establishment of infrastructure for an improved flow of goods (roads, ports, airports, bridges, railways); the strengthening of the production base (power stations, irrigation, natural gas pipelines, water supply); and counter-measures against large-scale disasters. As a result, the proportion of tied or partially tied ODA loans were 27% in 1999, 34% in 2000, 41% in 2001, and that fell back to 4% in 2002 on a commitment basis.[11]

Debt relief

As a result of providing large amounts of loans, up to the end of 2002, the ODA debt owed to Japan by all developing countries amounted to USD 97 billion (including USD 8 billion to LDCs). This amount was over four times more than that of the second largest ODA creditor, Germany, at USD 22 billion. In general, Japanese officials expect loan recipient countries to repay loans punctually, as Japan did to the World Bank, and consider unconditional debt relief to cause "moral hazard". Since most of the loans are generated from a separate source from the ODA's general budget, namely, from the Fiscal Investment and Loan Programme, whose source is predominantly the postal savings account, it also makes debt relief somewhat difficult due to administrative and accounting complications to replace the foregone repayments. Nevertheless, with the Heavily Indebted Poor Countries (HIPC) Initiative and other international efforts, Japan has been carrying out its commitments to debt cancellation for poor countries.

Japan's involvement with debt relief is rising. In 2001-02, this amounted to USD 1.3 billion or 13% of bilateral ODA, which was an increase from 4% in 1991-92 (see Table C-5). Between 1999 and 2002, Japan committed debt relief (including rescheduling) to 37 countries, particularly the following countries and amounts: Indonesia USD 1.3 billion, Pakistan USD 1.0 billion, Bangladesh USD 660 million, Tanzania USD 405 million, and Bolivia USD 334 million. During the same period, Japan continued to disburse the following amounts of loans to most of these countries: Indonesia USD 4.1 billion, Pakistan USD 804 million, Bangladesh USD 435 billion, and Bolivia USD 21 million.

Japan is committed to cancel all the HIPC claims when the debtor countries reach the Completion Point in the Enhanced HIPC Initiative. It has also contributed USD 256 million to the HIPC trust fund of the World Bank. Aside from ODA debt, HIPC countries owe Japan Other Official Flow (OOF) debt which include commercial debt. Under the HIPC Initiative, Japan has cancelled all these commercial debts in recent years, although it does not report the distinction between ODA and OOF debt cancellation to the DAC. For example, this amounted to about USD 360 million to Tanzania in 2000 and 2001, which were for Japanese commercial loans provided from the mid-80s and early 90s that were insured by METI [now by the Nippon Export and Investment Insurance (NEXI)] (see Chapters 4 and 6). The original contracts insured by METI were primarily for exporting vehicles, steels, and various machines by Japanese trading companies to the Tanzanian government or to a state corporation. While these contracts are commercial, the debt relief uses tax payers' funds and is counted as ODA. At the same time, although the ODA Charter requires increased transparency, the Japanese government does not publish detailed information regarding the contractor due to business confidentiality rules. Japan is encouraged to carry out lessons-learned in having provided non-ODA loans and credits to poor countries that resulted in using public funds to relieve the debt.

11. *Source*: MOFA.

Some aid officials realise that it is important to pay more attention to the debt sustainability of poor countries. Although Japan's lending is based on its own experience of reconstruction, its post-war foreign debt service ratio to exports did not exceed 4%.[12] That of some other DAC members was also low.[13] By contrast, Japan continues to lend to countries that have debt service ratios between 8% to 27% (*e.g.* Vietnam 8%, Bangladesh 9%, Sri Lanka 10%, India 13%, Philippines 14%, Thailand 16%, Indonesia 25%, Uzbekistan 26%, and Pakistan 27%).[14] However, it can be noted that Japan has been a lender to some countries which have experienced rapid development and graduation from aid though their debt-service ratios were high: Korea 32% (1987); Malaysia 25% (1988). Japan's position is that it provides ODA loans to developing countries that it does not consider are facing debt repayment problems and that debt relief will be arranged within the framework of the Paris Club when debt repayment difficulties occur.

As described in the last Review, regarding HIPCs and some eligible poor countries, Japan provided debt relief by first making the debtor country pay the amounts due and then giving an equivalent amount in grants. This was an attempt to enable the recipient country to maintain integrity and minimise the moral hazard. However, there was criticism over the cumbersome nature of the procedure for the recipient country, particularly in preparing the foreign exchange, for what ultimately resulted as financial equivalence. In response, Japan decided to change its modality to a straightforward debt cancellation like other DAC members, starting April 2003. The Japanese officials and population have had to come to terms with the fact that many developing countries do not necessarily have the same capacity as Japan in terms of ability and commitment to repay, recognising the impact of political instability, ethnic conflicts, primary commodity price declines and natural disasters. In general, although JBIC applies the IMF debt sustainability analysis, clear lessons-learned on providing loans to poor countries would seem to be essential in determining the future lending policies in Japanese co-operation.

Allocation by region and income group

In terms of substance, Japan has a regional perspective and has recently carried out some initiatives for Africa and Asia (see Box 2). In terms of quantity, Japan's bilateral regional and income level disbursements have remained more or less the same since the last Review. As suggested in the ODA Charter, the majority went to Asia at 70% in 2001 (Total DAC 39%), 11% to the Americas (Total DAC 15%), and 14% to Africa (Total DAC 33%), of which 10% was SSA (Total DAC 26%). In 2002, disbursements to Asia increased to 74%, of which most went to the Far East (see Table C-3). However, over the long term, this constitutes a reduction from 83% in 1976. With about USD 6.7 billion aid to Asia, Japan is still by far the largest donor, providing almost half of all DAC ODA to the region. Although the proportion of allocation to SSA is relatively small in real terms and has not increased despite the TICAD meetings, with its USD 722 million, Japan was the fourth largest bilateral donor to the sub-region in 2001.

The 2001 DAC High Level Meeting (HLM) statement mentions that "priority will be accorded to countries with low incomes. Some targeted assistance to other countries with a large proportion of poor people may also be provided". Although Japan has a clear policy on focusing on Asia due to

12. OECD estimate. Other data in this section are from MOFA.

13. In 1951, after World War II, Germany was asked to use 10% of its export earnings to repay the debts, but it renounced this ratio as unsustainable. Eventually, the Allies agreed on payments of 3.5% of export revenues. British repayment of debts owed to the US after World War II was capped at 4%. *Source*: Jubilee Research, http://www.jubilee2000uk.org/opinion/archive/ghana.htm.

14. *World Development Report 2002*.

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geographic, economic, historic, and cultural reasons, it is yet to develop a policy regarding poor countries or specifically on the poor population. In 2001, of Japan's bilateral ODA, 16% went to LDCs (Total DAC 26%), 45% to Other Low Income Countries (Total DAC 33%), and 34% to Lower Middle-Income Countries (Total DAC 35%). Japan's disbursement to LDCs as a proportion of bilateral ODA is the fourth lowest among the DAC. The top ten recipients of Japanese ODA for 2001-02 were China, India, Thailand, Indonesia, Philippines, Vietnam, Bangladesh, Pakistan, Sri Lanka, and Brazil (see Table C-4); only Bangladesh was an LDC. However, six were Low Income Countries and the list includes the world's top five countries with the most number of absolute poor. In addition, Japan figured as the largest donor in 54 countries and as the second largest donor in 27 countries. Among African countries, Japan was the largest donor in seven countries. Japan could usefully clarify its policy on how it intends to focus on poor countries or the poor populations within countries.

Box 2. Examples of Japan's recent initiatives and conferences

TICAD: Japan hosted TICAD III in September 2003, a decade after the first conference. TICAD I contributed to raising the challenges of African development when many donors were shifting their assistance to post Cold War Eastern Europe. TICAD II adopted the "Tokyo Agenda for Action", a comprehensive strategy based on Africa's ownership and international partnership, which encompasses areas such as i) social development (*e.g.* education, health) and poverty reduction; ii) economic development (*e.g.* agriculture and private sector); and iii) good governance and post conflict development. TICAD III carried out stocktaking of TICAD I and II, including exploring concrete measures to support the New Partnership for Africa's Development. In the TICAD process, Japan has been especially promoting "Asia-Africa co-operation" so as to foster linkages and knowledge sharing between the two regions.

IDEA: In 2002, Japan launched a new initiative to consolidate the experience and knowledge accumulated through the economic growth in East Asian countries. A meeting was held in Tokyo with Ministers of foreign affairs and development from 10 ASEAN countries plus China and South Korea. A Joint Ministerial Statement was issued which recognised ODA as a catalyst in promoting investment and trade. Particularly deemed useful was the appropriate combination and sequencing of various ODA schemes, such as south-south cooperation and macro-economic assistance. The synergy between IDEA and TICAD III is currently being explored in order to enhance Asia-Africa Cooperation. The second IDEA meeting is expected to be held soon.

In 2001-02, Japan had a total of 144 recipient countries, a slight decrease from 152 in 1991-92. The top five[15] have not changed for a decade and, in total, receive almost half of allocable bilateral ODA, which means that Japan's country distribution is relatively concentrated and stable. In 2000, Japan was the largest donor to 54 countries (20 in Asia, 15 in Latin America, 7 in Africa, 6 in the Middle East, 5 in Oceania, and 1 in Europe) in net disbursement terms. From this point of view, further concentration of recipient countries may not be entirely appropriate for Japan, but from a management perspective – particularly with understaffing (see Chapter 5) – the need for a Japanese presence in countries receiving small levels of ODA could be re-evaluated.

ODA to China alone amounted to USD 1.2 billion or 14% of allocable ODA in 2001-02. As mentioned in Chapter 1, aid to China has recently been under increasing criticism due to the country's rapid growth. In particular, some Japanese industries have suffered from Chinese competition, which the population often considers as a factor that exacerbates the recession. As a result, the government announced in 2001 a reduction of about 25% aid to China for 2002 as well as a change in the focus of its aid from coastal to the poorer inland areas - although the latter had been mentioned during the last Review (see China Report in the 1999 Review).

15. China, India, Thailand, Indonesia and the Philippines.

Sector distribution

A consistently prominent feature of Japan's bilateral ODA in terms of sector distribution is its relatively high proportion of economic infrastructure, which amounted to 37% (mainly through loans) in 2001-02 while the Total DAC for 2001 was 15% (see Table C-5) and unweighted average of 8%. The difference is more prominent if compared with the Total DAC without Japan figure of 10% and unweighted average of 7%. In particular, the road sector followed by the energy sector took up large shares.

The second largest category was social infrastructure and services at 21% (Total DAC 33%), of which education - mostly tertiary - was the highest at 8%. In 2000-01, Japan's allocation to Basic Social Services (BSS) was the fourth lowest among the DAC members at 7% (DAC average 15%). This also contrasts with the World Summit on Sustainable Development (WSSD) target level of 20%. While pro-poor economic growth is necessary for poverty reduction, there is also a strong link between effective commitments in BSS and achieving six of the MDGs, which requires specific resource allocations.

Japan could usefully rethink the fact that only a portion of resources to the social sector is actually directed towards BSS[16] which would qualify for the WSSD 20/20 Initiative. As mentioned in the previous review, Japan's allocation in the social sector tends to be directed to the tertiary levels such as universities, research institutions, urban water systems, hospitals, and so on. Sustainable development would be impossible without access for the poor to adequate services for health, education, water, and sanitation. MOFA could revisit its position regarding Japan's commitment to the Copenhagen 20/20 Initiative and consider having a more balanced portfolio in Japan's aid programme. In particular, Japan has had strong national basic education and health care systems which would seem to give it an incentive for being engaged more in the software aspects of these areas.

Multilateral aid

Although there are some references to priorities in the ODA charter, Japan is yet to develop an official and comprehensive policy on multilateral aid. Nevertheless, as a leading contributor to international organisations, Japan is endeavouring to take greater initiative and to influence the management of these organisations in the direction of its basic policies, especially in the enhancement of their effectiveness and strengthening of their financial integrity. Japan also pursues collaboration and co-operation with organisations in areas where they are especially experienced and have comparative advantages, such as assisting countries that are difficult for Japan to reach. MOFA states that the budget allocation to multilateral organisations is decided under the following criteria, although not exclusively: efficient management; role and visibility; reflection of Japanese policies in the strategy; effort to increase Japanese staff;[17] and effective utilisation of Japanese contributions.

Japan is the second largest donor of multilateral aid and contributed USD 2.7 billion to various organisations in 2002. At the same time, its proportion of multilateral aid in total gross ODA has generally been lower than Total DAC average. In fact, Japan's proportion was ranked the lowest among the DAC member countries in 2001 at 19% when the DAC's unweighted average was 34%.

16. Page 228 in the 2002 ODA Annual Report (in Japanese), which states that Japan has achieved the 20/20 Initiative from 1993 to 1998, may be inconsistent with the data it submitted to the DAC.

17. Japan is one of the most under-represented countries in international organisations compared to its funding levels.

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Among the UN agencies, Japan provides relatively high levels of support to agencies such as the World Intellectual Property Organization (WIPO), the United Nations Development Programme (UNDP), the United Nations High Commission for Refugees (UNHCR), the United Nations Children's Fund (UNICEF), the World Food Programme (WFP), and the World Health Organization (WHO). In 2001, Japan was the largest contributor to the United Nations Educational, Scientific and Cultural Organization (UNESCO), the United Nations (UN) University, WIPO and the United Nations Industrial Development Organisation (UNIDO). The head of UNESCO is a Japanese national and the UN University is situated in Tokyo. WIPO is an important organisation for Japan as it gives assistance to developing countries in respecting intellectual property, which is vital for the Japanese commercial sector. UNIDO is also a key organisation for Japan since it promotes industrial and private sector development, technology transfer and FDI.

Concerning the International Financial Institutions (IFIs), Japan sees that these institutions have advantages in donor co-ordination and policy advice based on their wealth of experience, technical knowledge, and political neutrality. Japan tries to actively contribute to their activities, utilise their policy dialogue and aid co-ordination functions in its bilateral programme, and also have Japan's ODA policies and development philosophy reflected in their activities. Some examples of collaboration include support to the Asian financial crisis, Afghanistan reconstruction, and the report on the East Asian Miracle. As for the regional banks, Japan has clear preference for the ADB, but also contributes to the African Development Bank and the Inter-American Development Bank (the share of Japan's contribution is as follows : ADB 15.8%; EBRD 8.5%; AFDB 5.5%; and IADB 5.0%).

Domestic co-ordination on multilateral aid issues is improving. The MOF, which is the lead ministry for the IFIs, co-ordinates with MOFA on positions to take at the board meetings. MOF also meets with NGOs regularly to discuss, for example, Japan's positions on policies and projects of the IFIs and other macro-economic issues. In the Executive Board of IFIs, MOFA and JBIC staff are being seconded to provide technical support to assist the executive director sent from MOF. As for co-ordination with other DAC members in multilateral aid, there seems to be some scope for enhancement, as Japan has had a tendency to remain independent. Japan could try to join forces with other like-minded members, and help further shape discussions on issues such as on economic growth, infrastructure development, and the promotion of the private sector.

Future considerations

- Japan should make every effort to increase ODA levels as economic conditions improve, building broad-based public support to facilitate this.

- Lessons learned from the provision of loans to indebted poor countries that resulted in large debt relief should be factored into future lending policies.

- The development of a clearer policy on how Japan intends to focus on poor countries and poor populations within countries should be considered.

- Japan should revisit its definition and practice of support for Basic Social Services, which includes only basic health and education and poverty-focused water systems, as opposed to tertiary and urban level support which Japan is predominantly supporting in the social sector.

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CHAPTER 3

SECTOR PRIORITIES AND POVERTY REDUCTION

Sector priorities

The overreaching framework of Japanese sector priorities is the ODA Charter, from which a hierarchy of strategies cascade down through the Medium Term Policy, country programming, sector-specific initiatives and to detailed project design (see Chapter 5). The Charter shapes the new vision of Japanese sector priorities into the following issue areas:

- Poverty reduction (education, health, water and sanitation, agriculture).
- Sustainable growth (infrastructure, trade and investment).
- Global issues (environment, infectious diseases, population, food, energy, natural disaster, terrorism, drugs, organised crime).
- Peace-building (conflict prevention, emergency assistance).

In contrast, the current statement of Medium Term Policy on ODA (1999-2004) established a priority for sectors under seven broad themes, ranging from poverty alleviation to debt relief. In recent years, Japan has also attempted to use its ODA to flexibly address emerging global challenges and Japanese domestic perspectives, usually multi-sector in nature. They include the Koizumi Initiative on Sustainable Development, the Consolidation of Peace Initiative, Human Security (see Box 3), the Okinawa Initiative on Infectious Diseases, the Environment Conservation Initiative for Sustainable Development, the Initiative for Japan's ODA on Water, and Japan's Comprehensive Co-operation Package to Address the International Digital Divide. This multiplicity of sector themes and initiatives sponsored by Tokyo leadership also has had the side effect of further dispersing the operational focus of Japanese ODA agencies.

As mentioned in Chapter 1, the Diet has become increasingly vocal in calling for a prioritised rethinking of Japanese ODA. Although the new Charter gives more strategic direction for the future shaping of Japanese ODA than did the 1992 version, to be effective, a more sharply defined and consistent sector prioritisation would be required through the Medium Term Policy, country strategy, sector and project level design. To move in these new directions, Japan would also need to re-examine the priority use of its ODA budget which is currently heavily oriented to economic infrastructure and other interventions that may not appropriately reflect the new spirit of the Charter priorities (see Chapters 1 and 2).

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Box 3. Two major initiatives

Human Security: Human security is a concept that calls for the removal of various threats to human survival, livelihood, and dignity so that individuals can lead free and creative lives. Japan has promoted human security as a key issue in development co-operation since 1998, particularly emphasising areas such as poverty, health, refugees, environment or peace building. Japan played a lead role in establishing the Commission on Human Security in 2001. It also initiated a Trust Fund for Human Security to carry out UN agency projects in this area and contributed USD 170 million to it. Strategically, the "human security" concept covers many interconnected sectors and themes that overlap substantially with existing Japanese priorities. The Japanese Government has yet to elaborate a plan for mainstreaming the concept within its own bilateral ODA.

Peace Initiative: In May 2002, the Prime Minister announced Japan's intention to "strengthen co-operation for the consolidation of peace and nation-building in countries suffering from conflicts". Since then, this policy has become a new pillar of development co-operation and one which has already resulted in support for security, humanitarian and rehabilitation assistance in East Timor, Afghanistan, Sri Lanka, Aceh (Indonesia), Mindanao (Philippines), and Iraq. As an example of Japan's commitment to the Peace Initiative, USD 450 million was allocated for Afghanistan after the International Conference on Reconstruction Assistance to Afghanistan in 2002 in Tokyo. The Afghanistan funds focus on infrastructure, but also support activities in disarmament, reintegration of ex-combatants, education, health, water, resettlement and gender. Japanese NGOs were provided some USD 4 million by the Japanese Government to implement emergency humanitarian activities. Japan also hosted the Donors' Conference on Reconstruction and Development of Sri Lanka. In July 2003, the Japanese Diet passed a bill to dispatch the Japanese Defence Force to help rebuild Iraq through humanitarian and reconstruction assistance. The bill had met large opposition domestically and from Japan's former Asian colonies which feared the gradual re-militarisation of the nation.

In practice, Japan has treated topics such as poverty reduction, gender, environment, and HIV/AIDS as specific sectors rather than cross-cutting issues. JICA is the exception and has developed some operational guidelines for dealing with the topics as cross-cutting issues within its own agency, such as poverty reduction (see Box 4). JBIC has treated them more as sectors.[18] MOFA, which administers grants, is still at the stage of studying possible options (special units and guidelines) for its involvement. In other words, Japan has yet to develop government-wide and monitoring systems in order to mainstream these cross-cutting issues - particularly poverty reduction - throughout the entire aid system. At a general level, Japan could better address these cross-cutting issues through a new system of inter-ministry co-ordination, described in Chapter 5. For this, MOFA, as the ODA institutional co-ordinator, has the main responsibility to ensure disciplined collaboration among all ODA actors.

Aside from poverty reduction, of particular importance is the cross-cutting issue of HIV/AIDS. While Japan has made major commitments to the Global Issues Initiative on Population and AIDS (USD 3 billion in seven years) and the Okinawa Initiative on Infectious Diseases (USD 3 billion in five years), it is still treating it as a discrete development challenge of funding related to the health sector, such as research, provision of equipment, counselling, and educational material development.

18. JBIC's main priority area (by the amount of funding) is infrastructure for economic growth, but other areas include poverty reduction, environment, global issues, human resources development, information technology, and provincial development. JBIC defines projects that target poverty reduction directly when a) the proportion of poor in the project target group is larger than the national proportion of the poor, or b) if more than half the target group is poor. In 2002, 13% of projects (in volume commitments) fell into this category. JBIC has recently issued a Handbook on Social Dimensions to address topics such as poverty reduction, health, social environment, gender, and so on, but the adherence to the guidelines is not mandatory. How to mainstream these issues throughout its ODA loan programme beyond just issuing a handbook would need to be elaborated. It has been announced very recently that the JBIC guidelines will take a proactive stance on the socially vulnerable, including the poorest, women and minorities.

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In other words, Japan is yet to see HIV/AIDS as a cross-cutting development challenge that needs to be addressed systematically in many other areas such as agriculture, rural development, education, public administration, tourism, business development, and so on. In particular, with significant activities in road construction and transportation development, it is crucial for Japan to analyse the situation and estimate the impact of HIV/AIDS at early project design stages and ensure incorporation of measures to mitigate the spread. JBIC has assisted in developing guidelines to mitigate HIV/AIDS risks in a bridge construction project in Vietnam - these types of measures should be systematically considered in all appropriate projects. Japan is strongly encouraged to establish a mechanism for effectively ensuring a government-wide approach to mainstream the cross-cutting issue of HIV/AIDS.

Box 4. JICA: Guideline for Poverty Reduction

In accordance with the global movement towards a greater poverty reduction orientation, JICA has begun to place more emphasis on direct poverty reduction efforts. Based on the DAC's Poverty Reduction Guidelines, the Agency developed a guideline for poverty reduction in 2002 (previously there was a manual) which elaborates its basic approach. It includes facts and a definition of poverty, principles for poverty reduction, strategy, as well as steps to initiate and points to heed in implementing poverty reduction projects.

The guideline explains the multi-dimensionality of poverty following the recent international discussions. It divides the types of intervention into three categories: poverty reduction through direct aid to the poor (micro level), poverty reduction through aid to each region (meso level) and poverty reduction through engagement in specific policies (macro level). It also mentions the importance of supporting not only economic infrastructure, but also education, health care and political and social stability. The guideline clearly mentions that JICA will be actively involved in the process of developing Poverty Reduction Strategy Papers (PRSPs) and will be consistent with the strategy. It also states the importance of ensuring the reduction of income gaps. The guideline also gives detailed approaches and methods for poverty reduction in the field according to the project cycle and key issues in dealing with poverty in rural and urban areas, respectively, as well as HIV, gender and the environment.

Japan's approach to poverty reduction

At the High Level Meeting in 2001, the DAC members, including Japan, resolved "to ensure centrality of sustainable poverty reduction in development co-operation, particularly at country level". Japan was one of the promoters of the Shaping the 21st Century Strategy and is also officially committed to the MDGs. At the same time, poverty reduction has yet to be treated as a central objective in the Japanese aid programme, and while the MDGs are sometimes referred to, there is little correlation with projects and programmes. In the previous Charter, although poverty was referred to as a challenge in developing countries, poverty reduction was neither a clear objective nor a priority. In the new Charter, however, poverty reduction is now included as one of four priorities.

Some MOFA officials state that poverty reduction and MDGs are not the only concerns in development co-operation. Hence MOFA could clarify what else is important for developing countries (in peaceful situations) as well as what it means for Japan to be "committed" to poverty reduction and achieving MDGs. It could also give a definition of development – how to measure it – and clarify how it could be sustainable if a large segment of poor, unhealthy, and uneducated people still exist. MOFA also mentions that countries need to "graduate", but could elaborate on what this implies, especially since Japan still provides significant amounts of Official Aid to ODA graduated countries and territories such as Brunei, Hong Kong, Macao, and Singapore, in particular to Korea, which amounted to USD 206 million in 2000-02.

MOFA has been emphasising "economic growth" or "development" more than poverty reduction. Japanese officials often say that they are proud of having contributed to the growth of Asia, but rarely mention whether they have contributed to its poverty reduction. The DAC Guidelines on *Poverty*

Reduction state that economic growth is important but that "it is not enough" and that "pro-poor growth" and "the quality of growth – its sustainability, composition and distribution – is equally important". This implies that economic growth is a necessary but not a sufficient condition and that supplementary measures and prerequisites are needed in order to realistically achieve the objective of poverty reduction. As some MOFA officials and particularly JBIC and JICA staff are beginning to refer to "pro-poor economic growth", the concept could be clearly defined and mainstreamed. As Japan holds the Vice Chairmanship of the DAC's POVNET, it could also actively pursue this concept with other DAC members.

The DAC and partner countries are progressively recognising the importance of economic growth in poverty reduction and therefore Japan's advocacy is a major contribution to the global debate. For example, both the Tanzanian and Vietnamese governments acknowledged the necessity of economic growth, which is reflected in their poverty reduction strategies. MOFA could substantially advance the discussion in development co-operation by focusing and linking growth clearly with poverty reduction, elaborating definitions, concepts, strategies on pro-poor growth, carrying out more empirical analysis, disseminating lessons learned from its extensive experience in Asia, and articulating what works and what does not. In particular, there are a growing number of studies and discussions among the Japanese implementing agencies, academia, and research institutions that MOFA could tap into as sources of information. As Japan aspires to take a more active role in the international aid community and in "strengthening Japan's standing in the international arena" – mentioned in the new Charter – it could increase its influence by taking more intellectual leadership. The following are some topics that may be useful for Japan to examine in order to pursue the discussion on poverty reduction and economic growth.

Applicability of Japan's development model

As mentioned in the last Peer Review, MOFA's development philosophy is based on Japan's own experience after World War II. It generally states that the nation developed itself rapidly by building infrastructure after borrowing loans from the World Bank and diligently repaying them. It therefore applies a similar principle in its aid programme, particularly to Asian countries, by supporting infrastructure development through mostly ODA loans and promoting FDI.[19] However, not many Asian countries today have similar conditions as Japan did after the war.[20] As one indication, Japan's post-war debt service ratio to exports did not exceed 4% while some of Japan's top loan recipients have ratios up to 27%, as mentioned in Chapter 2. Japan itself was also never dependent on FDI as it had its own capital and other domestic resources. In applying Japan's post-war nation building experience, clearer criteria regarding what pre-conditions must exist in the recipient countries, and what approaches are required when they do not, would seem desirable.

The Japanese government's request-based principle for project proposals – they are initiated by the recipient countries instead of being imposed by Japan – is commendable for respecting the sovereignty and ownership of the recipients. As explained in the last Review, this is also partially based on Japan's experience in nation building. The drawback is that good governance is a major

19. Frequently stated in Japan's ODA annual reports.

20. In post-World War II, Japan had already had a relatively well educated population, strong administrative and governance structures and systems, as well as a burgeoning domestic private sector. In particular, the Japanese bureaucracy had enough capacity to clearly determine what it needed in order to reconstruct the nation. Furthermore, under the US occupation, Japan also carried out an agricultural land reform which gave small farmers land ownership and direct means to reduce poverty.

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bottleneck in many developing countries. Many observers have commented that project proposals generated from individual ministries of recipient countries are frequently influenced by Japanese trading companies, manufacturers, technical co-operation advisors or politicians who operate under objectives which may not necessarily coincide with national priorities of recipient countries and could possibly lead to stand-alone projects with limited prospects for sustainability. While further efforts are required, Japan holds policy consultations with partner countries which the new Charter aims to strengthen, in order to promote local ownership and partnership and prevent such situations.

In the last Review, it was mentioned that Japan was reconsidering this request-base principle. The new Charter confirms this and states that it will be essential for Japan to engage "actively in policy consultation before requests are made by developing countries" and that it will set out its assistance policies through dialogue. The Charter recommends that Japan support efforts to improve policies and systems, "including the ability to formulate and implement assistance projects" and to "take into consideration whether such efforts by developing countries are sufficient in the implementation". While this pro-active approach could potentially lead to better project selection for poverty reduction, MOFA could clarify how it plans to balance respect for ownership, national interest, and the objective of poverty reduction.

Japan's comparative advantage in infrastructure - FDI model

Domestically, Japan has by far the highest per capita investment on general construction among the industrialised nations.[21] This appears to have influenced attitudes with respect to the role of infrastructure in development and the share of Japanese ODA going to support infrastructure. Also, as a major donor by volume, Japan has the financial scope to support infrastructure investment in a meaningful way. Given the high proportion of bilateral allocable ODA going for this purpose (37%), the question regarding Japan's comparative advantage in promoting infrastructure in developing countries is of major significance. The ultimate success of infrastructure development in developing countries is not only dependent on the hardware and engineering finesse but also on the software and financial aspects, including cost recovery, availability of recurrent and maintenance financing, pro-poor user charges, as well as adherence to social and environmental standards such as appropriateness of resettlements, environmental impact, and capacity building. How Japan incorporates these factors into its work in the infrastructure domain is important in assessing effectiveness and as a source of lessons and good practice for other donors, especially since there is renewed recognition of the role of infrastructure in development.

Due to their visibility, large infrastructure projects inherently carry high risks of being criticised when problems occur - the Japanese government is currently being sued by residents of Kotapanjung region in Indonesia regarding an ODA loan financed hydroelectric power project. However, JBIC has recently developed a guideline for environmental and social issues, which is considered one of the strictest guidelines among DAC members. This guideline is also applied to the export credit arm of JBIC, which is a good example of policy coherence (see Chapter 4). Regarding FDI, Japan's corporate management principles such as just-in-time delivery has also been adopted as a model in many South-east Asian companies. The guideline approach could be taken further; for example, MOFA could become more explicit on how ethical practices are applied to the private sector, such as attention to child labour, indigenous populations, gender equality, safety and health standards, and anti-corruption. MOFA could elaborate on where Japan is setting a leading example and has a comparative advantage, incorporating these issues, in promoting the infrastructure-FDI model (see Chapter 4).

21. In 1998, Japan's per capita investment was USD 4 975, while Germany's was USD 3 838, and the US's was USD 2 411.

Recurrent costs, opportunity costs, and debt sustainability

Whether economic infrastructure is provided by grants or concessional loans, there is nevertheless a cost associated for partner countries. The recipient country must generate recurrent and maintenance financing as well as human resources to manage the system. Poor countries often have difficulty in meeting these requirements. In Vietnam JBIC, together with the World Bank and ADB, is now supporting the establishment of mechanisms for maintenance capacity and corresponding budgets. Since resources are fungible, these partner country requirements for infrastructure also have a high opportunity cost with respect to spending for other important areas. Therefore, the expected economic, fiscal, and social returns from infrastructure development must be sufficiently high in order for them to be justified.[22] When large-scale loans are provided – including for infrastructure – thorough analysis on debt sustainability is required (see Chapter 2). Close co-operation with the Bretton Woods Institutions is already carried out by JBIC staff, but MOFA could also build more capacity in economic analysis. As Japan is currently faced with carrying out massive debt relief to many countries including HIPCs, MOFA could elaborate on the lessons learned from its past loan programme which resulted in debt relief as well as plans to prevent creating heavy debt burdens and shortage of recurrent/maintenance financing of poor countries in the future.

Lessons learned from infrastructure development, economic growth and the Asian crisis

Assistance to induce growth through infrastructure development has been a key activity among DAC members since the 1960s. This is in line with repeated Japanese statements about the central role of economic growth for poverty reduction, however, general economic growth does not necessarily lead to effective poverty reduction. In this regard, MOFA could explain step by step how the large JBIC loans to support, for example, the subway (USD 1.6 billion) and airport (USD 277 million) in Bangkok, railway electrification in Indonesia (USD 338 million), and highway rehabilitation in western Turkey (USD 243 million) could effectively contribute to poverty reduction and reaching the global MDGs. In the meantime, JBIC has recently attempted to measure impact of its infrastructure project on poverty reduction (see Box 5). It has also initiated a joint study with ADB and the World Bank regarding, *inter alia*, the importance of infrastructure development in economic growth and poverty reduction. Japan is in addition, playing a leading role in the DAC's new work programme on economic growth and poverty reduction, in particular the infrastructure component of this work.

While economic growth in Asia has been remarkable, Japanese leadership could reflect on the question of how to direct future programmes to address poverty reduction. Rapid economic growth has raised additional challenges, particularly prominent in many Asian capitals which currently face enormous challenges in mega urbanisation, pollution, traffic jams, slum sprawls, and other environmental and health degradation. Japan has provided assistance to redress some of these emerging problems through urban environment and transportation projects, but it would also be useful to analyse whether these actions address the root causes of poverty. The 1992 Charter directed that "consideration will be given to redressing the gap between the rich and the poor and the gap among various regions in developing countries". Some Japanese academics[23] encouraged Japan to take greater account of these disparities in the provision of its aid. [24] The new Charter repeats the "assurance of

22. JBIC is introducing an ex-ante evaluation method for expected returns from ODA loans projects, which is accessible to the public.

23. Hiroshi Nemoto, Journal of JBIC Institute #16, June 2003.

24. Between 1996 and 2002, among Laos, Thailand, Cambodia, Singapore, Indonesia, Vietnam, Philippines, and Malaysia, GDP growth has fallen in all countries except Cambodia and GDP per capita has fallen in all countries except Vietnam. Source: World Bank, IMF and ADB.

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fairness" as an important aspect of current Japanese development co-operation. Japan now faces the challenge of documenting lessons learned in this area. Japan is helping lead a project, together with the OECD Secretariat, to evaluate policy coherence issues in the East Asia region. This project will throw light on lessons learned regarding the successes and failures of economic growth, the determinants of growth, the role of aid and a deeper analysis of what underlay the Asian crisis and what can be done to minimise future risks, as well as to address more directly pro-poor growth needs and issues such as environmental sustainability. The risk of FDI dependency, as opposed to aid dependency, could also be explored in light of the volatile global FDI climate.

Box 5. JBIC's Impact Assessment of Transport Infrastructure Projects in Vietnam

While carrying out impact assessment of projects is extremely difficult, JBIC has tried a unique ex-post external evaluation that attempted to measure the impact of two transport infrastructure projects in Vietnam, which included effects on poverty reduction. The projects were: a) Rehabilitation of the national highway between Hanoi and Hai Phong (1994-2002, total cost USD 175 million) and b) Rehabilitation of Hai Phong Port (1994-2000 : Phase I completed, total cost USD 33 million). The assessment basically included a longitudinal and cross-sectional comparison such as the volume of cargo compared to 10 years ago, growth rate of gross regional product compared to non-project regions, increase in FDI, employment creation and so on. As for impact on poverty reduction, rates of reduction of poor households were compared between 1998 and 2000 based on the Vietnamese government statistics which showed that there were reductions along the highway, particularly in the province that included Hanoi. A household survey was also conducted that showed average per capita increases by communes and diversification of income sources. In addition, the evaluation analysed concurring interventions by the Vietnamese government that contributed to project outcomes, such as revision of the Foreign Investment Law, Doi Moi in agricultural policy, and expansion of agricultural extension and service credits.

JBIC sees the challenges of attribution and of evaluation design as significant, but nevertheless sees this as a valuable experience and example that is worth building upon, especially with an enhanced focus on the impact on poverty reduction.

Alternative model of economic growth through agricultural development

One of the key features of the MDGs is that each target has a timeline. This requires donors and partner countries to take necessary actions that would reach the goal most expeditiously and sustainably, for example, in halving poverty. While MOFA has been promoting the infrastructure-FDI model, particularly in Asia, it is somewhat reticent on the issue of growth through enhanced agriculture, though the majority of the poor in developing countries are rural farmers, even in Asia. Japan's MAFF is involved in project selection to identify suitable projects, but also to ensure that the activities will not be in conflict with the domestic agricultural industry. Even in Africa, where Japan's approach, stated in TICAD's Tokyo Action Plan, is to promote economic growth through agricultural development, the actual proportion of bilateral ODA allocated to the sector is still smaller than economic infrastructure, though the assistance to the agricultural sector is the highest percentage among DAC members.

On the other hand, Japan is taking key actions in agriculture, and the assistance provided to the sector is the highest among DAC members. For example in Tanzania, JICA has carried out extensive capacity building in irrigated paddy farming, and in West Africa, it has promoted the development of a new type of NERICA (New Rice of Africa) rice that is suitable to the conditions of the region. JBIC also states that agriculture is the engine of growth and provides substantial support to the sector. Furthermore, Japan has opened up and expanded its market access for LDC products, including 436 items from agriculture, forestry and fisheries, which could potentially benefit many African countries. If MOFA is to promote the concept of pro-poor economic growth, it could also explore more possibilities in agriculture, including addressing the issue of policy coherence (see Chapter 4) as an effective means to support poverty reduction.

Future considerations

- Japan should develop a government-wide approach to mainstream cross-cutting issues, rather than treating them as separate sectors, particularly concerning poverty reduction as part of achieving the Millennium Development Goals.

- Japan should ensure the centrality of poverty reduction in its programmes and increase its influence in the global community by elaborating strategies on economic growth and poverty reduction, carrying out more empirical analysis, disseminating lessons learned, and articulating clearly what works and what does not.

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CHAPTER 4

POLICY COHERENCE

The need to promote policy coherence for development

DAC documents emphasize that there are many areas where policies of industrialised countries can complement or frustrate development efforts[25] and the concept of coherence across a spectrum of policy areas has gathered increasing support at high level OECD discussions.[26] At the 2002 Ministerial Council Meeting, OECD Ministers recognized the need to bring greater coherence across a wide range of policies that impact on developing countries. These policies include trade, investment, agriculture, health, education, environment, fisheries, and security. Among these, the Doha Development Agenda for negotiations at the WTO makes agricultural and trade policy issues the most urgent, but the failure of talks at Cancún to resolve the conflict of interests between developed and developing countries show the challenges involved. The task is to identify and implement approaches that promote the mutual reinforcement of these policies to have a positive impact on development. At the same time, OECD member governments recognize that approaches are necessarily different; "one size does not fit all".

Examples of policy coherence for development in Japan's policies

Foreign direct investment

OECD considers FDI a major catalyst to development and suggests that developed countries can contribute to the promotion of these benefits by using ODA to leverage investments. It also advocates policy coherence for development more generally, for instance by facilitating developing countries' access to markets and promoting the OECD Guidelines on Multinational Enterprises.[27] Japan has promoted FDI in the Asian region, developing its own model for enhancing economic growth by linking trade and investment policies with development co-operation. At the heart of this model is Japan's belief in economic growth as the main driver of development. Other principles of its indigenous model, drawing inspiration from Japanese industrial practice, emphasize long-term partnership relations, regional clusters of suppliers, research and quality improvements, self-help and mutual benefit.

While the driving force behind FDI is Japan's private sector, the government of Japan has played an important facilitating role in the expansion of FDI, using both ODA and non-ODA funding. Several government institutions are involved in promoting FDI, under the overall charge of METI. For example, the Japan External Trade Organization (JETRO) promotes trade and economic co-operation between Japan and other countries. Specific activities with developing countries include the promotion of industrialisation in selected countries, especially Asia, to assist the development of the "supporting

25. *Shaping the 21st Century* (OECD/DAC, 1996) p. 18.

26. *The DAC Guidelines: Poverty Reduction* (2001).

27. *Foreign Direct Investment for Development: Maximising benefits, minimising costs* (OECD, 2002).

industries" that supply parts and components; exhibitions to help local suppliers find Japanese companies looking for sources; and human resource development. NEXI manages the Japanese trade and investment insurance, which insures both ODA and non-ODA investments, to reduce risks to Japanese firms involved in overseas transactions, and to deal with their diverse global finance needs.

The Japanese government considers that this outward FDI has benefits to the developing countries in the Asian region because of the impact on regional economic growth. OECD and Japanese studies show that this positive impact is achieved through the lifting of financial constraints leading to employment; enhanced access to Japanese and other markets resulting from intra-company trade; direct impacts on domestic and regional competition and enterprise development; and spillovers of technology and competences to the host economy. Japanese observers also point to the "graduation" of partner countries up the value chain.[28]

The concept of mutual benefit has been central to the success of Japanese trade and investment policy in East Asia for some years. The importance of mutual benefits was reiterated in 1998 when, despite a policy to reduce ODA, Japan approved an emergency aid package for countries affected by the financial crisis - recognition that Japan's economy is intertwined with the regional economy of East Asia. The package included special tied ODA Yen loans partially to encourage Japanese outward FDI in the region (see Chapter 2). Following this package, outward FDI recovered to Asia although the linkage was indirect. There is a significant risk, however, that the concept of mutual benefit will be eroded if the new ODA Charter leads to a narrow view of "national interest".

East Asian countries are key trading partners for Japan yet, currently, simple average tariffs are high (China 10%, Malaysia 15%, Korea 16%, Philippines and Thailand 26%, and Indonesia 38%). The Japanese government is pursuing bilateral and regional Free Trade Agreements (FTA), with the support of the private sector. Japan's priority is to move towards a Comprehensive Economic Partnership in the ASEAN region. These agreements deal with the overall trade policy context, and are expected to be mutually beneficial to Japan and its partners. The Japanese government considers that the advantages from increased competition from FTA are expected to outweigh negative impacts on domestic industries, which can be mitigated by economic reforms. It is interesting to note the contrast with the case of China - while the concept of mutual benefit is apparent in relation to ASEAN countries, Japan is challenged by the growth of China.

Some international observers have questioned the mutual compatibility of regional economic co-operation agreements and WTO disciplines, but Japan argues that it is aware of the necessity for WTO consistency. Japan has also been broadly supportive of the WTO agreements and negotiations, and would like to lower tariffs further on non-agricultural products in a multilateral deal. Along with other countries, Japan promoted these ideas at the Cancún meeting. The failure of these multilateral talks is too recent for a full appreciation to be considered. Japan could explain whether it will now more strongly pursue its bilateral regional economic co-operation agreements and FTA.

In recent years, several UN conferences (Millennium Summit, Doha, Monterrey, and Johannesburg) have called on countries to give importance to trade in promoting development. In this regard, developed countries have been criticised for not providing enough technical assistance to help developing countries to cope with the regulatory and institutional challenges they face when

28. See JBIC Institute (2002) "Foreign Direct Investment and Development: Where do we stand?"; (Research Paper 15); A. Kuchiki (2003) "Changing Industrialization Policy of East Asia under Globalization", Nagoya University Discussion Paper No. 113; M. Kagami and M. Tsuji (2003), "Industrial Agglomeration: Facts and Lessons for Developing Countries". Institute of Developing Economies, JETRO, and Kenichi Ohno (2002) "Development with Alternative Strategic Options".

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integrating into the multilateral trading system. In particular, the Doha Development Agenda was based on this adverse perception, and the setback at Cancún has reinforced it. In 2002, Japan provided USD 16 million for trade-related technical assistance and capacity building (TRTA/CB), which focused on trade policy and regulations. The aim was to assist developing countries to adapt to the new issues in the Doha agenda (such as investment, competition, trade facilitation, transparency in government procurement, and trade mainstreaming in PRSPs). This made Japan the third largest DAC member to contribute in volume terms on this issue.[29] Of this amount, Japan's contributions to LDCs on trade policy and regulations (Doha) amounted to USD 400 000. Japan also contributed USD 1 500 000 to the Doha Development Agenda Global Trust Fund, and a contribution of USD 500 000 to an Integrated Framework for LDCs.

According to MOFA, several developing countries have faced difficulties in meeting their obligations under WTO Agreements.[30] In this context, Japan launched its "Strategic Plan" for capacity building to help some APEC countries (*e.g*. Indonesia, Malaysia, Philippines and Thailand) implement WTO agreements and gain benefits from the multilateral trading system. For instance, Thailand faces significant constraints in developing its legal system to facilitate the private sector. Japan provides support for trade-related technical assistance and capacity building by JICA and other bodies, covering 4 500 people in the five-year period from FY 2000. This will supplement the work that JETRO does in training for developing countries. At the same time, METI is encouraged, through JETRO, first to increase support for mainstreaming trade into developing countries' development policies and poverty reduction strategies, and secondly, to supplement this capacity building with further work to address developing countries' supply side constraints, such as helping to raise product standards.

Japan has carried out studies of the East Asian experience and has indicated in various international meetings that the experience may have lessons for other regions, while recognising the challenges of applying this FDI model to other parts of the world. MOFA is encouraged, with JBIC, MOF and METI, to undertake an analytical review of the lessons learned from Japan's experience in this area and to work with other DAC members to reflect on this experience to apply elsewhere. Such a review might consider, *inter alia*, the risk to countries of FDI dependency.

Studies of FDI impact should also consider environmental and social effects, which are not generally addressed by regional economic co-operation agreements (though Japan-Singapore may be an exception). [31] Some Japanese NGOs have claimed that forestry investments had resulted in negative effects but Japan has taken steps to address these issues (see Box 6). JBIC research considered whether there might be adverse environmental and social dimensions of FDI and examined if OECD-based firms move production to countries where there are lower environmental standards or where there is weak protection of core labour standards. Although JBIC concludes that there is no empirical evidence for this argument, it has recently developed guidelines for "Confirmation of Environmental and Social Considerations". It expects these to be applied to borrowers when recipient countries apply for ODA loans or where companies seek export credits, thus encouraging coherence between the two forms of support. At the same time, the borrower and related parties should supply the necessary information for JBIC to monitor the application of the guidelines. JBIC has established objection

29. TRTA/CB also includes work on trade development, for which Japan provided USD 35 million. This made Japan the sixth bilateral donor in volume terms for this category of technical assistance. Japan's contribution to LDCs for trade development (technical assistance/capacity building) was USD 2 million.

30. See http://www.mofa.go.jp/policy/economy/summit/2002/policy-f.html.

31. This issue was discussed at a presentation in September 2003 at the OECD by Shujiro Urata, "New Partnership Agreements and Development Strategy in East Asia."

procedures for outsiders and an Office of Examiners. When necessary JBIC also conducts its own investigations. Although problems in projects can affect future applications for loans and export credits, there is a need for a more rigorous monitoring system.

Box 6. Enhancing Environmental Controls on Japan's Forestry Investments

Japan is the world's largest importer of wood, pulp and paper products. In 1999, its total tropical timber imports – logs, sawn wood, plywood etc. (calculated in terms of roundwood equivalents) - accounted for 25% of world trade. Malaysia and Indonesia are the source of more than 80% of Japan's tropical timber.

In the past, many complaints were lodged against Japanese timber and trading corporations, but also against JBIC and JICA for providing ODA for the development of plantations and pulp mills in Malaysia, Indonesia and elsewhere. Japan Tropical Forest Action Network (JATAN), Greenpeace Japan, and Friends of the Earth Japan have claimed links with deforestation, illegal logging, environmental pollution and loss of local livelihoods in these countries. JATAN has also traced how Japan shifted its timber sources since the 1950s every time forest resources became depleted or action had been taken to curb logging.

In 2002, the Japanese Government stated its support for certification for wood producing countries through ITTO. Various importers, traders and users of tropical wood have also expressed their interest in forest-friendly certification. For example, the Mitsubishi group (and other large companies) have signed up to the Forest Stewardship Council's certification scheme, which audits forest management practices and certifies "well managed" forest areas. In June 2003, the Japanese Government signed the Joint Announcement on the Co-operation in Combating Illegal Logging and Trade in illegally logged timber and wood products with the Government of Indonesia. Japan has also promoted international efforts to tackle the problem of illegal logging, such as at the G8 Summit at Evian.

Governance is another area of concern in FDI for all OECD members. Japan has signed the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which requires countries to establish the criminal offence of bribing foreign public officials and to have in place reliable means for detecting the offence and adequate sanctions and enforcement. At the same time, MOFA and METI do not have guidelines on governance issues in export credit operations which appears to be an area for self-regulation by the private sector.[32] In this respect, the Japan Business Federation (Keidanren) has a Charter on Corporate Behaviour, which stresses attention on environmental, social and governance issues. The private sector is concerned by such issues because they can affect the reputation of Japanese companies, with implications for future activities. Governance is often addressed in regional economic co-operation agreements, but this is usually in the context of the partner country's governance.

For all these environmental and social concerns and governance issues, OECD recommends the Guidelines for Multinational Enterprises, which represent standards for responsible corporate conduct. Therefore, Japan is encouraged to consider these issues in its regional economic co-operation agreements. In particular, the DAC encourages Japan to establish a convincing system for monitoring compliance with such a code of conduct, covering social, environmental and governance issues during the project identification and implementation phases. The system should be developed with the collaboration of implementing agencies and Japanese companies, and make clear the framework of sanctions to be applied in the case of non-compliance.

32. For ensuring good governance under ODA loans, JBIC has "Implementation Rules for Sanctions Against a Party Engaged in Corrupt or Fraudulent Practices under a Contract funded by JBIC ODA Loans".

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Japanese food and agriculture policies and imports from developing countries

Recent DAC Peer Reviews have been critical of other DAC members providing export subsidies to their farmers since this can adversely affect developing country agriculture. Japan does not provide export subsidies on agricultural products and such a policy is not on Japan's agenda.[33] However, as with other DAC members, there is protectionism of the domestic agricultural market, which is effected through administrative prices and state purchases, trade protection and production limits. This protectionism has implications for imports from developing countries.

Agricultural policies have addressed the decline of Japanese agriculture by promoting rural development, preserving the landscape and securing Japan's food supply. Japan characterises these various aims in terms of the "multifunctionality of agriculture". Furthermore, the domestic food policy emphasises stable food supply, food safety, and facilitation of consumer choice by provision of information. The Basic Law on Food, Agriculture and Rural Areas (1999) sets out the framework for Japan to secure a stable food supply by managing domestic food production and imports, with an official policy target of producing 45% of total calorie intake by 2010. Japan's agricultural support is provided predominantly through price support and administered prices, underscored by restrictions on imports and supply management regimes; though the number of agricultural commodities subject to administered prices has declined and the remaining administered prices have been reduced or frozen since 2000.

Japan imports 60% (on caloric intake basis) of its food. In 1999, 45% of its imports of agricultural and fisheries products came from developing countries, an increase from 40% in 1990. Japan is the largest net food importer from developing countries (USD 15 billion),[34] representing USD 135 per capita in 1999. Fishery products comprise the largest category of imports from developing countries. On the other hand, the main exporters of key commodities (rice, wheat, and sugar) to Japan are developed countries. Nonetheless, liberalisation of Japanese agricultural markets could benefit several Asian developing countries and territories – particularly China, India, Indonesia, Philippines, Taiwan, Thailand, and Vietnam, although primary benefits might accrue to higher-income countries. South Africa and various South American and Pacific countries would also benefit on present trade patterns, and others could also benefit as production is stimulated by the opportunities offered by enhanced market access.

The 1999 Peer Review discussed import barriers to agricultural products, including high tariffs on rice, tariff escalation on processed foods, and other restrictions such as sanitary and phyto-sanitary procedures, and state management of certain agricultural products, such as rice, milk products, and raw silk. These barriers and restrictions are still applicable, including on several important agricultural commodities. One result is that Japanese consumers pay high prices for these commodities, especially for rice.

In recent years, there has been policy development aiming at setting the scene for agricultural negotiations in the WTO. The import quota on rice was abolished, as Japan moved to tariffication. There are two tariff levels - a very low one for the minimum access quantity and a much higher one for imports above the minimum. Japan implements Minimum Access rice importation in accordance

33. Japan does not generally export food, except under its food aid scheme. Japan uses a part of imported rice, as well as domestic rice, for food aid in response to requests by international organisations such as WFP. Japan exports some processed foods, but this is minimal.

34. The EU and US are larger gross importers with USD 34 billion and USD 21 billion respectively, but they also export significant amounts to developing countries.

with WTO rules to implement rice production adjustments inside the country. Imports of rice have barely exceeded the minimum access quantity, suggesting that the higher tariff is acting as a block on imports. In defending its policy in relation to WTO rules about agricultural liberalisation, Japan maintains that the multifunctionality of agriculture and food security should be considered, along with issues of benefits to developing countries and consumers.

To address the problems of LDCs, Japan has proposed a specific initiative for enhancing the Generalized System of Preference (GSP) scheme. With a view to further enhancing LDC access to the Japanese market, Japan expanded the coverage under duty-free and quota-free treatment for LDC products from April 2003 (see Box 7). This is a similar approach to those taken by the EU (Everything but Arms) and the US (African Growth and Opportunity Act) and the aims of the Japanese scheme to help the developing countries are equally welcome. At the same time, as in those other schemes, significant challenges of market access remain for some commodities that are excluded from the scheme, notably rice and sugar. These exclusions adversely affect developing countries with high proportions of low income employment in agriculture. There are also provisions for emergency suspensions of the scheme and for excluding certain products from certain countries, which could introduce unpredictability into the scheme. These provisions have been used in recent years, justified by food safety concerns, but it is important for Japan to avoid possible criticism that it uses these provisions for protectionist reasons. Japan is thus encouraged to reconsider these anomalies in its GSP scheme and to develop measures to help developing countries to reach the full potential (*e.g.* capacity building in production and marketing to meet Japanese standards, and promotion of good environmental, social, and safety regulations).[35]

Box 7. Japan's Tariff Preferences for Agricultural Products from LDCs

From April 2003, Japan enhanced the terms of GSP for LDCs. It covered 47 LDCs and 436 agriculture, forestry or fisheries products out of 2 287. This includes duty-free and quota-free access of products originating from LDCs, which includes vegetable products, fats and oils, animal products, and marine products. Japan estimates that 93% of the value of all products imported from LDCs - both agricultural and industrial - will be covered by the new scheme (up from 83%). Specifically for agriculture, forestry and fishery items, the coverage is estimated to rise to 83% (up from 56%) of imports from LDCs for these items. Those agricultural, forestry and fishery items that remain outside the scheme include rice, specific forestry products, sugar, beans, and beef. These exclusions are because there would be "significantly adverse effect on the production of domestic farm products competing with such imports".[36]

The WTO Agreement on Agriculture also committed Japan to reduce the Aggregate Measurement of Support (AMS) by 20% (against the 1986-88 level). After some initial efforts, support for some key products crept back up until 1999 when it became the same as before 1986 (rice 88%, wheat 88%, and sugar 67%). In 1999, 65% of farm receipts came from support from government policies.[37] OECD estimates that Japanese agricultural support was USD 59 billion in 2001 (1.4% of its GDP, representing 59% of the value of the agricultural output).[38] OECD also concluded that the

35. OECD promotes full trade liberalisation as a more effective means than GSP to support LDCs in the long term.

36. MAFF (2000), The Basic Law on Food, Agriculture and Rural Areas, Article 18 (policies on imports/exports of farm products).

37. The average proportion for OECD countries is 40%.

38. Comparable figures in 2001 were for the United States USD 95 billion (0.9% of GDP, and 21% of value of output) and for the EU Member states USD 106 billion (1.4% of their combined GDP and 35% of value of output). Source: OECD (2002), *Agricultural Policies in OECD Countries: Monitoring and Evaluation*.

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"support remains among the highest in the OECD countries and is dominated by the most production and trade distorting measures." An earlier OECD report calculated the overall Producer Support Estimate (PSE)[39] for Japanese agriculture to be 63% during 1998-2000, and producer prices were about three times world prices in 2000, even though administered prices have been lowered. In contrast, Japan had significantly reduced its production support for beef and tariff protection; by 2000, the tariff equivalent for beef was about 39% (a fall from 50% in 1993). The result was that consumer prices had fallen and consumption had risen significantly. Japan has now imposed emergency restrictions, which raise its tariff up to the bound rate of 50% by responding to an import surge and were in place until March 2004. However, most beef imports originate from the US and Australia, and not from developing countries.

The Japanese government maintains that general liberalisation in Japan will mainly help developed countries, rather than developing countries. Japan argues that, within developing countries, China will be the most likely winner, while other developing countries will lose their preferential trading arrangements which help them to compete. LDCs will not benefit much at all, because of the lack of capacity to supply the needs of the Japanese economy. Other constraints are concerns over Japan's high dependence on food imports and desire to maintain the multifunctionality of agriculture in society. The government also refers to public opinion to support its policies in these areas. For example, the public is wary of environmental damage caused by the liberal use of pesticides on crops in some developing countries and wishes to maintain quality and freshness of food. Japan is encouraged to undertake further analysis on these issues and, where they are valid, to explore alternative solutions that will be of mutual benefit to developing countries and Japan's consumers and rural areas.

Challenges and opportunities for improvement in policy coherence for development

Policy

Some DAC members, recognising the impact that their domestic and foreign policies can have on development, have started to develop policy statements that set development co-operation policy within a broad range of other policies. They have also started to make institutional arrangements to deal with the issues of policy coherence for development. In contrast, Japan does not have an explicit statement about policy coherence for development, covering the whole of government. Nor does policy coherence for development find an explicit place in the new ODA Charter (see Chapter 1). Furthermore, there is no visible promotion of the concept among the public, which appears sceptical of ODA and unaware of issues of policy coherence for development. Nonetheless, Japan's Charter recognises the broad dimensions of development, since Japan's own economic growth, environmental health and security are dependent on global events and on regional developments - a recognition shared by the public. Japan should set out explicitly the links of development co-operation with other foreign and domestic policies, giving emphasis to the broad dimensions of development, including pro-poor economic growth, social and environmental issues, and the rationale and mutual benefits of such a broad concept.

Co-ordination

There are many government, private and non-profit organisations involved in operations that promote Japanese trade and investment in developing economies, particularly in China and the

39. The PSE measures the level of support to producers irrespective of its nature or impact. The PSE is a more comprehensive measure than the WTO's AMS, which only includes those forms of support agreed to be the most trade-distorting.

ASEAN countries. Since 2000, a council of these organisations has been meeting under the Chief Cabinet Secretary. The new ODA Charter also aims to strengthen collaboration between ODA related ministries and agencies, using the consultation forum of the Inter-Ministerial Meeting on ODA. Therefore, the institutional arrangements for co-ordination between ODA related institutions provide opportunities for enhancing policy coherence. In particular, this concerns three ministries - MOFA, METI, and MAFF. Although MOFA has been assigned the central role of co-ordinating ODA related organisations, METI also has a key role in Japan's economic co-operation system by providing leadership in policy formulation on trade and investment. In contrast, MAFF is one of the many ODA-related organisations, dealing with domestic food and agriculture policies, which can provide technical experts for development operations. MAFF is consulted on the linkages between development projects and domestic policy interests, with emphasis on the latter. If MAFF officials promote domestic interests at the cost of development, there would be a risk of policy incoherence for development. Attention should be given to mechanisms for managing this risk, such as MOFA to represent the voice of developing countries.

Analysis

In comparison with the wealth of information on developing countries' market access into the EU and the US, Japan appears to do relatively little analytical work on the impact on developing countries and its own consumers of opening its markets and liberalizing its domestic agriculture (a notable exception is a research programme with the OECD on East Asia). The lack of understanding of the issues at hand may be as much an obstacle to policy coherence for development as the lack of political will. Potentially, the co-ordination Council could deal with policy coherence for development, but there is little information gathering or analytical capacity, and the Council has only met rarely. Japan should give urgent attention to the need to establish capacity for analyzing policy coherence for development issues, and to promote these throughout the Japanese system. It may also be possible to increase the capacity of the Japanese system to analyze potential cases of incoherence, by creating networks between the existing ministerial institutes. Other DAC members are also trying to find ways to address these institutional challenges through the development of specialised policy coherence analysis units. MOFA, given its co-ordinating role, could also discuss approaches and experiences with these members, with a view to sharing lessons and formulating its own institutional approach.[40]

Broad-based involvement

Improvements in the area of policy coherence for development will depend on political leadership perceiving the benefit to Japan. There are clear indications of a broad interpretation of national interests among some private sector interests, which support the policy of improving trade capacity of partner countries so they can become better partners for Japan. For example, supermarkets wish to reduce the cost of food by seeking imports and have already transformed the structure of the Japanese food industry. Consumers are also concerned with food safety, quality and price of food. These voices have differential effects on the government ministries. It will be important for Japan to take a proactive stance in leading the discussion on these issues, rather than reacting to the advocacy of particular interests. It is recommended that the Japanese authorities seek ways to educate the public on the issues of policy coherence for development and to promote a discussion of the way poverty reduction of developing countries might converge with Japan's long-term interests.

40. MOF is supporting a joint research project with OECD by conducting a regional case study on the impact and coherence of OECD country policies on Asian developing economies.

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Future considerations

- The government of Japan should make a policy statement on coherence for development, and seek ways to educate the public on this issue.

- The Japanese government should enhance analytical capacity on policy coherence for development in order to improve its ability to take appropriate policy decisions.

- The Japanese government should collaborate with the private sector and civil society to set up a system for monitoring the environmental, social and governance aspects of FDI and of regional economic co-operation agreements.

- Japan should reconsider anomalies in its GSP scheme regarding LDCs and help them to meet Japan's safety and quality standards through trade-related capacity building.

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CHAPTER 5

ORGANISATION AND MANAGEMENT

A mandate for change

In 1998, Japan initiated a government-wide reform which included a 2001 law that reaffirmed the overall co-ordination of ODA agencies by MOFA. It also assured JICA the status of "Independent Administrative Institution", new requirements for evaluation and feedback of ODA policies and projects, and a variety of Diet recommendations for improved ODA transparency, effectiveness and efficiency. The Diet's debate on the reform concerning the management of Japanese ODA highlighted the extent to which it has been less a "system" than a loosely co-ordinated network of actors. The debate noted the historically compartmentalised approach to the different Japanese mechanisms of ODA (loans, grants, technical co-operation) carried out by the separate ODA administrations. One suggestion was to organise ODA operations around a single bureaucratic entity, but this was considered to contain operational disadvantages and to be politically unrealistic in the current context. However, the Diet insisted on greatly improved co-ordination among all ODA actors and the urgent requirement for MOFA to ensure greater "system" synergies. Some Diet members believe that strong cross-government co-ordination may create ODA efficiency (*e.g.*, common strategic vision, more timely and co-ordinated inputs, common operating systems at reduced cost).

The most important proposal for the reform of ODA operations since the last Peer Review was produced in March 2002 by the Second Consultative Committee on ODA Reform. Its report[41] underscored the importance of effectively using ODA for national interests and made operational recommendations on better use of human resources, clearer articulation of ODA strategy and a more efficient ODA implementation system. Consistent with this proposal, MOFA declared its intent to implement immediately a reform process based on public participation, transparency and efficiency. This process has begun in five specific areas: (i) auditing, (ii) evaluation, (iii) partnership with NGOs, (iv) human resources, and (v) information disclosure. Part of that process was the launching of a major, participatory exercise which led to the revised ODA Charter.

A network of development co-operation institutions

Development co-operation is the shared responsibility of institutional actors located both in the Japanese government (ministries, implementation agencies) and outside it (NGOs, private sector entities, academic institutions). Table 1 below provides a highly simplified outline of the roles of some key institutional actors. The major players in the government are the three ministries, MOFA, MOF and METI, of which MOFA has a core co-ordination role, and two agencies (JICA and JBIC) play major roles in implementation. With the exception of JICA, these organisations have major responsibilities in areas other than development co-operation as well. The administrative units responsible for ODA programmes within these institutions are highlighted in Annex D.

41. The first consultative committee, the "Council on ODA Reforms for the 21st Century" produced similar conclusions four years earlier (1998) in its final report.

Table 1. Key Development Co-operation Institutions

Institution	ODA Responsibility	Size
Ministry of Foreign Affairs (MOFA) *(essentially Economic Cooperation Bureau – ECB)*	Leads ODA policy and interagency co-ordination; administration of most grants, administrative oversight of JICA and JBIC/OECO; co-ordinates UN operations.	**33%** of ODA (of which MOFA administered 19%, transferred to JICA 10% and to UN 5%), 435 development staff.
Japan International Cooperation Agency (JICA)	Implementation of technical co-operation and "expediting" of much of MOFA grant assistance and JBIC project design.	10% of ODA, re-allocated from MOFA; 1200 development staff; 90 overseas offices.
Japan Bank for International Cooperation (JBIC) *(essentially Overseas Economic Cooperation Operations – OECO)*	Implementation of ODA loans, private sector investment finance, studies.	51% of ODA (of which, 14% re-allocated from MOF, and 37% from special FILP loans).
Ministry of Finance (MOF)	Manages pass through funds for JBIC; co-ordinates IFI operations; specialised analysis.	**59%** of ODA (of which 11% transferred to IFIS, 1% to others, and 47% transferred to JBIC).
Ministry of Economy, Trade and Industry (METI)	Trade and investment; Asia-Japan economic relations; energy and environment. Also includes trade promotion institutions JETRO and NEXI.	**3%** of ODA
Other important official institutions (a) *Ministry of Education* - MECSST (b) Other: Ministries of *Health* - MHLW, *Agriculture* - MAFF, *Land* - MLIT, *Public Management* - MPMHPT, *Justice* - MOJ, *Environment* - MOE, and agencies for the *National Police*, *Financial Service*, and *Cabinet*	(a) Overseas students and university exchange. (b) Technical co-operation.	**5%** of ODA
Non-official institutions (a) Non-governmental organisations (b) Private sector (c) Academia	(a) Policy advocacy and debate, project implementation. (b) Policy lobby, implementation contracting. (c) Studies, policy advocacy.	(a) 0.4% of ODA obtained from official sources; 250 NGOs in development, most with budgets in the USD 50-250,000 range.

Source: OECD, Government of Japan
(See Annex E)

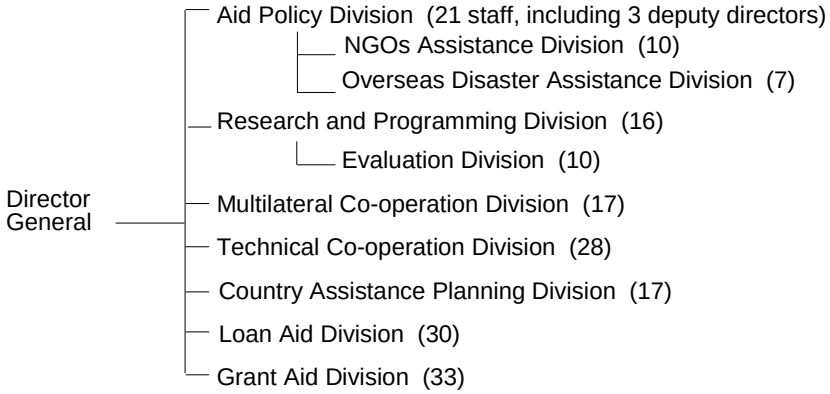
MOFA plays a core co-ordination role in Japanese ODA. The Minister co-ordinates the operational responsibilities of 10 different foreign affairs bureaux, headed by the respective Director Generals (see organigramme in Annex D). The Economic Co-operation Bureau (ECB), and to a lesser extent the Multilateral Cooperation Department (humanitarian assistance, and international organisations such as UNCHR and UNICEF), the Economic Affairs Bureau (international organisations such as WTO), and the geographic bureaux (regional development conferences such as TICAD) are responsible for development-related operations, including grant assistance and parts of the UN's ODA portfolio. ECB leads the ODA policy formulation and interagency co-ordination, including on the annual ODA budget process. In system terms, this places the ECB in the forefront of ministry interface with the other implementation agencies and ministries.

The location of the ECB's role for development co-operation within MOFA offers opportunities for greater policy coherence among the various aspects of Japanese foreign policy, although development co-operation is only one part of overall ministry priorities. As was pointed out in the 1999 Peer Review, ECB is very thinly staffed and includes a large number of secondments, who rapidly rotate back to their ministries of origin. ECB (and, therefore, development co-operation) competes with the other nine director generals for the attention of the minister, who is generally the main voice of development co-operation on the cabinet. Current internal organisational reform is intended to strengthen ECB's ability to co-ordinate with the development agencies, although staffing

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will continue to be an issue. ECB operations are largely organised around assistance instruments (Grant, Technical Co-operation, Loan and Development Co-operation divisions) but the lead Aid Policy Division (see ECB organigramme in Figure 2) and the Country Assistance Planning Division give growing importance to strategic co-ordination at the country level. This emphasis at the country level also raises the operational issue of how to co-ordinate with the other MOFA geographic bureaux, the implementation agencies, and the field. For example, the Africa Division of the geographic bureau has been responsible for TICAD while it does not have any ODA instruments. JICA and JBIC are organised around country desks, but their interlocutors at ECB are not. Many other DAC members have had to grapple with similar issues of co-ordination within headquarters and the field, and it should be possible for Japan to use this experience to move more rapidly to an effective, country-based operational system.

Figure 2. Organisation Chart - Economic Co-operation Bureau of MOFA



Source: OECD

Of the two "implementation agencies" of Japanese development co-operation, **JICA** is the largest ODA institution in terms of the size of the staff and is the only institution to be entirely specialised in development co-operation. It has multiple responsibilities, including lead implementation of about half of Japanese technical co-operation, a support role ("expediting")[42] for the implementation of much of the MOFA's grant portfolio and for some JBIC project design, and a variety of other tasks, from training programmes to administering the Japan Overseas Co-operation Volunteer programme.

In October 2003, when JICA took on the status of an "Independent Administrative Institution", agency operations became more autonomous and flexible, including personnel and organisational management, subject to organisational performance evaluations and various disclosure obligations. JICA operates according to mid-term (3-5 years) objectives defined by MOFA, around which it prepares a mid-term plan and subsequent annual plans. The initial JICA mid-term planning is currently focused on increasing efficiency ("reduce unit costs for major forms of input by 10% on average over the next three years") and improving the quality of services (*e.g.* shifting to a field-oriented approach, reinforcing project formulation, implementing peace-building operations, promoting public participation, and mobilising non-governmental resources). Organisational evaluations of JICA is made by the Evaluation Committee of MOFA.

42. "Expediting" is defined as supporting the proper execution of Japanese grant assistance.

This new status introduces a number of challenges for JICA management, including the need to adapt to a multi-year planning system. However, it is expected that this new status will improve its efficiency, transparency and accountability. Perhaps one symbol of the new JICA is the recent appointment by the Foreign Minister of a former head of the UN Commission for Refugees as the new President of the Agency.

A second, somewhat smaller implementation agency (but not in terms of its funding responsibility) is **JBIC**. It was formed in 1999 as the result of a merger of the former OECF and JEXIM. JBIC now believes that this organisational merger has reduced transaction costs through the use of common systems and the closer collaboration on important issues like the relationship between ODA and FDI. A concern of the 1999 Peer Review was that this merger could cause a blurring of responsibilities between very different development and commercial operations. JBIC constructed an administrative firewall between the two functions to address this concern which left it with a bifurcated organisational structure composed of the Overseas Economic Co-operation Operations (OECO) group and that of International Financial Operations (IFO). OECO's role (ODA loans, private sector investment finance, studies) is essentially ODA funded, while that of IFO is not. To accomplish their different mandates, the two sides of JBIC report administratively to two different entities (MOFA and MOF, respectively) and maintain largely different sets of procedures. About one-third of JBIC funding is allocated to the OECO, and approximately one-third of staff works there. JBIC has 27 field offices, most of which have some type of OECO functions.

The **MOF** has a role in development co-operation by virtue of its 59% share[43] (including FILP[44] funds) of total Japanese ODA - mainly pass through funds for JBIC and the IFIs - and its lead liaison responsibilities with the IFIs. The MOF also maintains a specialised analytical capacity (sector strategies, debt issues, macro-economics) that could prove helpful in supplementing other agency capacities in these areas as the ODA network is co-ordinated better over time. As with MOFA, the MOF also is responsible for a wide range of domestic functions. The International Bureau is the MOF organisational focus for development co-operation. Some 67 staff in the International Bureau are engaged in ODA related issues. The MOF addresses issues of development in the IMF, the World Bank and the regional development banks.

Outside the government ODA system, but collaborating closely with it, is a significant variety of **NGOs**, as well as the **private sector** and elements of **academia**. They collectively play an important role in the Japanese system, particularly in influencing political decisions in the Diet, but are fairly minor in terms of their operations in development. In particular, the **NGO** movement in Japan is small but growing in acceptance with the emergence of important umbrella organisations. NGO funding as a proportion of total ODA in 2002 was only 1% (2% of gross bilateral ODA or 3% of grants), but it has been increasing continuously since 1999. As was noted in the 1999 Peer Review, the majority of Japanese NGOs working in development co-operation are still under-funded and under-staffed compared to their counterparts in other DAC member countries. According to the Japanese NGO Centre for International Co-operation, it is estimated that only 19% of NGO funding comes from subsidies and contracts from government and UN agencies, and some 66% comes from donations, membership fees and income generating activities. Key ODA agencies are now taking a greater

43 . Japanese officials note, however, that this share is only 29% in terms of the General Account ODA budget (see Annex E).

44. The Fiscal and Loan Programme (FILP), is a large, government-wide system to collect funds through government financial institutions (most notably postal savings) to finance public projects undertaken by the government. JBIC uses the FILP system to fund some two-thirds of its ODA loan operations. Also see Annex E.

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interest in funding NGO projects and in organising other collaborative events, such as study groups or joint evaluations. NGO relations with these governmental bodies were described as cordial, but yet too complicated and slow. Experience from elsewhere within the DAC would suggest that the government could be more proactive in supporting NGOs, including innovations in grants for NGO organisational development or better understanding of the NGO comparative advantage so as to promote additional collaboration and funding.

Changing management systems

Issues of system flexibility

There are at least three characteristics of Japanese ODA management that appear central to future reform: (i) **institutional specialisation,** (ii) **co-ordination**, and (iii) **decentralisation**.

Institutional specialisation

Japan still carefully distinguishes among its three key aid instruments: (i) grants, (ii) technical co-operation and (iii) ODA loans. Lead institutional responsibility for each of these categories largely belongs to MOFA, JICA and JBIC, respectively. Of particular interest to the future efficiency of Japanese ODA management are the categories of grants and technical co-operation, both of which are so operationally related that the distinction between them often appears artificial. The separation of bureaucracy between MOFA and JICA can cause additional transaction costs and challenges, *e.g.* when JICA has to carry out technical co-operation for a grant assistance programme but must also fit into MOFA's fiscal timeline, or, alternatively, when the grant assistance is suddenly inserted into JICA's multi-year rolling plan. This separation between grants and technical co-operation also causes confusion at the level of co-ordination with development partners who do not easily identify their Japanese counterparts.

From the perspective of MOFA, for whom development co-operation ought to be a strategic preoccupation, the essential rationale for its control over grant assistance is its role in Japanese diplomacy and the furthering of national interest. Indeed, after identifying uses for the grants, MOFA allocates much responsibility for implementation to JICA. This process, while politically consistent, introduces operational inefficiencies and a tendency to separate strategy and implementation.

The DAC encourages its member states to accord priority to the needs of the recipient country and to the efficiency and effectiveness with which this aid is implemented. Growing acceptance of field-based approaches to aid programming, including the use of sector approaches and locally-led strategies, is causing donors to question long-standing, traditional management approaches and complexities which are increasingly seen as constraints to these new directions of development. Japan is now seeking to test flexible sector approaches that complement those of other partners in the field. This suggests that Japan should continue to weigh carefully the political and bureaucratic interests underpinning its distinction between grants and technical co-operation with the parallel and sometimes conflicting Japanese policy objectives of ODA transparency, efficiency and effectiveness. Attention should be given to those administrative arrangements that bring these two types of aid into a more complementary and synergistic relationship. To the extent that MOFA maintains its leadership at the strategic level, the entire sequence of project planning and implementation could be moved to an experienced developmental agency like JICA. Perhaps a relatively non-controversial step could be a formal re-delegation of grant leadership and funding responsibility for the project cycle - project identification, design, implementation, monitoring and evaluation - to JICA. Such re-delegation would offer MOFA the advantages of ending its management of aid instruments, and redistributing its limited resources toward the priority mandate of system co-ordination, strategy and policy development.

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Extensive co-ordination

To co-ordinate the many official agencies within the Japanese development co-operation system, Japan has put in place an extensive network of management mechanisms. At the **inter-agency level in Tokyo**, instruments of co-ordination have recently been set up at almost every administrative level. This new and ambitious scheme of co-ordination (see Table 2) across government is now being implemented around a system of liaison bodies at the bureau and division level. MOFA also recently strengthened its collaboration with the other ODA ministries.

Table 2. Inter-ministerial Co-ordination

Forum	Responsibility	Participants	Observations
Council of Overseas Economic Cooperation-Related Ministers	Basic economic development policy	Chief Cabinet Secretary Chair; Ministers of all (8) economic co-operation ministries	– (re) Established December 2000 – Meets when necessary
Inter-Ministerial Meeting on ODA	Discussion of major ODA issues	ODA bureau directors-general, plus Cabinet; MOFA Chair	– Established March 2000 – Meets when necessary
Bureau Meetings for Inter-Ministerial Meeting on ODA	Negotiates ODA proposals for Inter-Ministerial meetings	All (12) ODA division directors; MOFA chair	– Meets more frequently than Inter-Ministerial Meetings
Experts Meeting on Technical Co-operation	Exchange views and collaborate on related projects	All (12) technical co-operation division directors, plus Cabinet	– Established April 1997
Experts Meeting of ODA Evaluation	Formulate guidelines for evaluation, review evaluation outcomes	All (12) evaluation division directors; includes scholars, experts, NGOs as observers	– Established July 2001
Experts Meeting of Financial Co-operation	Discuss and coordinate grants, loans, OOF and trade credits	MOFA, MOF, METI, JICA, JBIC, NEXI financial co-operation division directors	– Established November 2002
Board on Comprehensive ODA Strategy	Public advisory council to MOFA on issues of ODA strategy	Senior Vice-Minister and a wide range of civil society, chaired by MOFA Minister	– Established in June 2002 – Role in determining future target countries

Source : The Government of Japan and OECD.

At the **inter-agency level in the field**, all embassies with development co-operation portfolios are now required to set up an "ODA Task Force" which brings all agencies at post together on a regular basis for purposes of collaboration. The Task Force is also expected to form networks with experts, NGOs, foundations and other Japanese expertise in the field. The Task Force has officially been given a role in information gathering, strategy development, negotiations with the local government, and collaboration with other local donors. Japanese agencies with similar mandates, such as JBIC and JICA, are now working more closely together in their field operations. Inter-agency co-ordination seems to be more easily obtained at this more operational level where specific actions can be discussed and where operational efficiency takes precedence over respect for bureaucratic boundaries. This could suggest the utility of Japan decentralising some aspects of its co-ordination processes in line with current interest in greater delegation to the field. At the level of its **co-ordination with other partners**, Japan increasingly seeks mutually acceptable development options through collaboration in international forums on regional strategies (*e.g.* TICAD and IDEA), topical alliances with specific donors (*e.g.* with the US on HIV/AIDS), or broader consultation with international groups such as the DAC. Field evidence shows Japanese interest in more actively engaging local collaborative efforts such as the PRSP or Consultative Group forums and their sector co-ordination groups (see Chapter 6).

The overall spirit of operational collaboration with this range of other key partners is highly consistent with DAC guidelines and the current world-wide interest in improved aid efficiency. However, many interlocutors point out that Japan is a consensus based society and that the complexity of the system being put in place will have high transaction costs. Many of these mechanisms are very

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new and therefore merit periodic senior management evaluation to determine their value and best directions for the future.

Towards new forms of decentralisation

Stimulated by the mandate from the Diet, the ODA Charter and the external committees on ODA reform and strategy,[45] Japan is now also slowly moving toward greater decentralisation of operations to the field level, especially through use of country strategies and the new ODA Task Force team concept. Although no legal obstacle to greater decentralisation of ODA operations and decision-making appears to exist, Japan's historical context of highly centralised administration and the special interests of the different ODA institutions create bureaucratic obstacles. The vertical organisation of Japanese ODA structures means that operational decentralisation will take place at different speeds. JICA, for example, already has initiated its decentralisation planning; JBIC remains largely Tokyo-based but with many operational authorities delegated to field offices; and MOFA is observing the initial results of its pilot efforts in countries like Vietnam (see Boxes 8 and 10 and Chapter 6). A first major challenge is to determine how far the Japanese government ultimately wishes to delegate authority to the field and then to shape the necessary system for decentralisation. More specific and critical organisational issues, such as the exact role of the ambassador or how to best manage the very different mandate and interests of embassies and the implementing agencies, will need to be addressed. Finally, it is also clear that current government-wide downsizing and ODA budget cuts will make the staffing of decentralised systems difficult, once the vision is more clearly established.

Box 8. The Vietnam ODA Task Force

An ODA Task Force in Vietnam was established in March 2003, after a directive from MOFA requiring all Japanese embassies with ODA programmes to establish such a group. The Task Force meets weekly under the leadership of the embassy minister and includes developmental representatives of the embassy, JBIC, JICA and JETRO. Special meetings are also organised with Japanese NGOs and other partners. Since the ODA Task Force model is a priority, the minister remains extremely involved. The Task Force pursues a task-oriented agenda, currently highly focused on the new Country Assistance Programme (CAP). Sub-groups can be formed to address specialised topics (*e.g.* drafting an education sector strategy). As this team concept evolves, it may be expected to cover a growing spectrum of more operational issues (ensuring that strategy leads project design, policy coherence, co-ordination issues among ODA institutions and partners, etc.) which may require increasingly specialised management and resources.

As with several other donors, the extensive use of external contractors and consultants has historically been a way for Japan to keep the size of its official development staff and organisation relatively small, while substantially satisfying the commercial and intellectual interests of the Japanese private and academic sectors. Contractors are involved at each stage of the project cycle. At the design stage, the implementing agencies sub-contract much of the responsibility for project development to (especially Japanese) contractors and consultants, under the general supervision of the agency. Project implementation and monitoring and evaluation also make extensive use of contractors (including non-Japanese), who work closely with the recipient country counterparts, especially in the context of "project management units" or similar host country administrative mechanisms. Although perhaps

45. DAC guidelines on decentralisation note: "Locally-owned country development strategies and targets should emerge from an open and collaborative dialogue by local authorities with civil society and with external partners, about their shared objectives and their respective contributions to the common enterprise. Each donor's programmes and activities should then operate within that local framework, and respect and encourage strong local commitment, participation, capacity development and ownership."

technically competent, criticism inside and outside the Japanese aid system frequently point to the lack of language capability of these contractors who can often work only in Japanese. Being able to carry out dialogue with local partners in participatory approaches and ensure co-ordination with other actors on the ground is becoming increasingly important. Therefore, Japan is encouraged to establish and implement an all-government criteria for minimum language requirements according to recipient countries in the selection of contractors.

Making management strategic

The use of the CAP in recipient countries is seen by Japanese leadership to be one of the most important tools in support of more strategic, better co-ordinated and more effective allocation of ODA. A CAP is generally designed around a five-year cycle. Only 15 CAPs have been approved to date but the intention is to develop one for all major recipient countries. This systematic approach to country strategy is consistent with DAC experience in strategic allocation of ODA and with the recommendations of the 1999 Peer Review.

Since 2003, new CAPs are designed by the Japanese ODA Task Force with local development partners and aim to be consistent with locally-owned national development strategies, such as the PRSP. This is consistent with the strategic principles that are increasingly gaining acceptance within the DAC. At the same time, the country-based approach also calls into question some aspects of the ODA administrative system. For example, Japan currently lacks a country-based budget approach (see Box 9) which would make its work more efficient and more easily understandable for its partners. With Japan now moving away from its "request-based" approach to programming, the construction of its budget around a CAP will make it easier to engage in local dialogue on key policy issues.

Box 9. Country envelopes

Japan does not organise its funding around country envelopes, as the budgetary system is largely instrument- (ODA loans, technical co-operation, grants) and organisation-based (MOFA, JBIC, JICA, etc.). Remembering that Japan is one of the largest donors to many developing countries, this can cause difficulties for recipients and partners alike, since there is little predictability in terms of financing commitment toward the partner country. This approach also creates inflexibility concerning the transfer of funds within the sector when problems occur. A country envelope would allow more flexibility in adapting to the changing situations of a project or the country. The lack of such a flexible approach is particularly at odds with the increasing trend toward sector approaches, where different instruments need to be complementary within a predefined financial and programmatic framework. Some aid officials have also found this to be a handicap in carrying out policy dialogue and negotiating with recipient countries.

Evaluation management

Japan has actively pursued improvements to its system of ODA feedback since the last Peer Review. Impetus for this change has come from public and political messages to reform the ODA system in favour of greater transparency, accountability and efficiency. The specific roles and responsibilities for ODA performance feedback depend on the institution. MOFA (and other related ministries), JICA and JBIC all evaluate their portions of the ODA portfolio of activities. MOFA (ECB's Evaluation Division) focuses on **policy** (ODA Charter, mid-term policies, country policy, special policy issues) and **programme** (sectors) evaluation, and JICA and JBIC place their primary emphasis on **project**-level evaluation. While this information tends to rise vertically within the framework of each of the ODA organisations, a growing effort is being made to share feedback among agencies so as to encourage a process of common learning. MOFA formed joint committees on ODA

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evaluation feedback (Internal ODA Evaluation Feedback Liaison Committee) and to share perspectives among ministries (Experts Meeting of ODA Evaluation).

At the level of implementation, the degree of co-operation between JICA and JBIC is noteworthy and has led to numerous efforts to share information, including joint evaluations. Japan has also emphasised the importance of ODA recipient countries taking greater responsibility for their own evaluations, which it promotes through the use of joint seminars (Tokyo Workshop on ODA Evaluation, 2001 and 2002) and other opportunities, as they arise. Japan now also assists in building the evaluation capacities of some recipient countries as part of their local ODA programme.

Ensuring the transparency and credibility of ODA performance feedback currently is a growing preoccupation of Japanese political leadership. All evaluation reports are public, whether produced by MOFA, JICA or JBIC, and most are made electronically available on the agency web. Each ODA institution has its own Evaluation Committee, composed of external specialists, through which individual evaluation quality and methodology can be examined. An annual evaluation report is sent separately to the Diet members for their reference by MOFA, JICA and JBIC. The Board of Audit also has a special administrative section to track the use of ODA[46] and external audits have now been extended to all schemes of development co-operation (ODA loans, grants, technical co-operation). Nevertheless, these various efforts are not complemented yet by a regular system of follow-up on the findings and recommendations to ensure that lessons-learned are applied in future programming. In particular, challenges by recipient countries in securing recurrent and maintenance costs have been pointed out in numerous evaluations over the years, and yet new projects do not seem to address this point adequately. It is important that these evaluations are not perceived as being simple data generating exercises that ultimately become an end in themselves.

Japan is in the earliest stages of setting up a more operational "results-based management" (RBM) approach to its ODA. Efforts to date are specific to the individual agency. JBIC has introduced a form of RBM at project and agency levels, but not yet at the country programme level. Its Evaluation Office is attempting to better link the results of its projects to the MDGs. JICA uses the individual project logical framework to shape its results-based system. It also plans to use mid-term planning targets as a way of addressing the MDGs. JICA staff also noted the difficulties of developing a useful baseline in many of the LDCs. Some Japanese specialists noted their concern that excessive focus on a results-based approach may limit Japan's ability to undertake the development activities actually needed.

If Japan continues to reform its systems in line with current political expectations of greater transparency and effectiveness, ODA organisation could become less compartmentalised. This would offer the possibility of moving toward a more common, results-based monitoring and evaluation reporting system among all agencies, a trend which has already been noted in the DAC. A second, longer-term trend noted in the DAC has been the increasing donor emphasis on policy or programme learning over that of projects. As Japanese ODA organisation and management continues to evolve, evaluations - together with programming - should permit the entire ODA establishment to shape one coherent national development programme. It will also require a further strengthening of the technical and management capacity of Japanese ODA evaluation units, particularly that of the ECB, to foster greater synergy among the different parts of the Japanese system.

46. However, the public outreach function of the Board of Audit may merit attention. Requests to the Board to obtain information on Tanzania and Vietnam for this Peer Review were not successful.

Human resources management

The Japanese government's statistics are not organised so as to permit readily an integrated view of all official staff responsible for development co-operation. At present, Japan does not have an integrated ODA personnel policy, nor a mechanism which focuses on the co-ordinated use of this staff across agencies. Table 3 attempts to assemble the evolution of most types of ODA staff over the last several years.

Table 3. Estimated Evolution of Japanese ODA staff resources

Institution	1977	1982	1987	1992	1997	1998	2003
MOFA (a)	151	205	270	371	442	430	435
of which: overseas (b)	54	97	146	218	269	258	245
OTHER MINISTRIES (a) (c)	98	99	100	107	110	108	120 est.
JICA	579	741	867	1 023	1 173	1 180	1 213
of which: overseas	57	111	156	254	324	329	369
JBIC (d)	180	235	252	297	333	332	329 est.
of which: overseas	15	22	33	49	54	54	54 est.
TOTAL STAFF	1 008	1 280	1 489	1 798	2 058	2 050	2 097 est.
***of which*: overseas** (e)	126	230	335	521	647	641	668 est.
GROSS ODA/STAFF (USD million)	1.6	2.6	5.5	7.3	6.1	6.2	6.1

Source: MOFA and OECD.

(a) Includes only those directly in charge of each ministry's ODA budget; other bureaux may also be occasionally involved.

(b) Attachés seconded from other ministries to MOFA missions are counted as part of MOFA.

(c) Includes aid-related staff of MOF, METI and the Economic Planning Agency.

(d) The total for 2003 is the number of ex-OECF staff at the time of the JBIC merger in 1999.

(e) Does not include contracted experts or volunteers.

JICA is the largest ODA agency in terms of staff size with a total 1 213 development staff world-wide, some 369 of whom are located in the field. JICA staff represent the full range of development co-operation skills, from expertise in technical sectors to expertise in more general management field (*e.g.* contracting, financial management and procurement). Second largest is MOFA, with an estimated 435 staff who are focused on ODA activities, some 245 of whom are located in the field. JBIC, at the time of its merger in 1999, had an estimated 329 development staff, including 54 persons in the field. JBIC no longer differentiates between its development staff and those working in international finance, but today's staff levels overall have declined since then. This suggests that Japan currently has a **total staff** level of some 2 097 Japanese development professionals to manage its world-wide portfolio of USD 9 billion, an estimated 668 of whom are located in the field. Seen in ODA system terms and as has been noted in previous peer reviews, Japan continues to be among the more thinly staffed DAC members. Its overall human resource capacity is further reduced by the fact that MOFA development staff and those temporarily seconded by other ministries often rapidly rotate out of development co-operation – representing a loss of human resources to the ODA system.

Under-staffing has frequently been mentioned as a major constraint to decentralisation. To the extent that Japan deepens its resolve to operationalise this approach, a collaborative review of personnel strategy and options will be needed, in a manner that is consistent with the organisational and management changes noted earlier. Options for this review that could be supportive of decentralisation include: (i) better use of local professional or contract staff in the field, (ii) a potential shift of functions to the field, reducing the size of certain types of Tokyo staffing in favour of the field, pending review of cost and other factors, or (iii) better use of resources already in the field by reducing

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institutional compartmentalisation. On the last point, the new ODA Task Force team concept now required of all ODA missions offers a promising opportunity to foster greater synergy among Japanese agency field staff. Such a comprehensive review would not be complete, of course, without a more holistic understanding of other organisational features, for example, (iv) a re-evaluation of the need for a Japanese presence in very small countries or greater prioritisation in the selection of recipient countries, and (v) transfer of greater funding responsibility to the multilaterals or NGOs, among others.

There is currently no experience requirement nor substantive formal development training for foreign service officers of MOFA who work in the ODA area. Prior to their assignment in the field, the Japanese Foreign Training Institute provides 2-3 days of general orientation to development issues for MOFA staff and some 2-3 months of development training for secondments from other ministries. Because of the need to maintain a cadre of experienced professionals, MOFA is encouraged to consider establishing a career track in the "development" category, so as to attract and maintain the kind of high level staff that will be needed to carry out the current ministry mandate in strategic co-ordination and policy. Furthermore, under any decentralisation scenario, it will be important to raise the level of professional skills (*e.g.* technical, negotiation, language) so as to create a more consistent and dynamic ODA team that can progressively take charge of partnership and collaborative operations in the field.

Future considerations

- MOFA should consider organisationally moving away from an instrument based co-operation system to a more country based approach as well as establishing country budget envelopes.

- MOFA should consider delegating most grant management to JICA. MOFA should focus on its leadership role in strategy, policy development and system co-ordination.

- Japan should move towards a more integrated ODA evaluation system as well as develop a clearer follow-up mechanism on findings and recommendations.

- More development staff are needed across the system, particularly if decentralisation is to succeed. An integrated ODA personnel policy should be established that includes planning and analysis of development staff levels and skills.

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CHAPTER 6

COUNTRY OPERATIONS

Country strategy and organisation

Regional differences and country strategy[47]

Japan's strategies for Vietnam and Tanzania are representative of the different regional perspectives frequently referred to in Japanese development co-operation. **Vietnam** is a centrepiece of Japan's approach to Asia (see Box 10). The Vietnam programme is justified around strong, geographical, commercial and security interests, but clearly also notes the level of poverty of the country and the extent to which the Vietnamese are actively taking charge of their own development. Vietnam is the sixth largest recipient of Japanese ODA in the world and the aid mission there is currently used as a pilot to test new organisational reforms. The CAP focuses on economic growth strategies, especially with an emphasis on infrastructure, policy dialogue and institutional capacity building as key to both national socio-economic development and to poverty reduction. The CAP makes heavy use of development loans (65% of the current portfolio) and therefore offers a strong institutional role for JBIC. In contrast, and consistent with the cultural and economically different context of Africa, Japan has adopted a more cautious approach in **Tanzania.** The Asian economic growth model has worked less well in Tanzania and Japan is prudently moving toward an emphasis on learning, particularly in collaboration with other partners. Because of Tanzania's low level of development and its past inability to repay loans (80% of the Tanzania portfolio is currently composed of debt relief), funding there is now totally in the form of grants, giving JICA a strong institutional role.

The Country Assistance Programme

The CAP most clearly defines the rationale and strategic framework for Japanese development co-operation in a specific country. In **Vietnam**, the initial CAP that was established in 2000 is now being revised (see Box 8) by a local ODA Task Force team in a manner more explicitly in line with Vietnamese-owned strategy for poverty reduction and economic growth. Collaboration with partners, including the Vietnamese government and civil society, Japanese NGOs and other donors, has been conducted regularly, and main discussion documents are prepared in English. Japan's pilot effort to establish greater strategic co-ordination and integration at the field level in Vietnam is consistent with DAC experience elsewhere and merits the attention and support of Japanese leadership. It could be reinforced in the future by tighter linkages with local strategic processes (such as the sector working group in agriculture) or any other sector level collaboration. Vietnam could offer an ideal setting for Japan (and others) to analyse and explain how poverty reduction is addressed through economic growth, especially through activities in infrastructure (see Chapter 3). The clearer and more convincing analysis and information that can be extracted from the Vietnamese experience is of interest to the DAC, and will help Japan better target its large local portfolio while helping to inform others of its importance.

47. The content of this chapter draws extensively on the field visits to Vietnam (7-11 July 2003) and Tanzania (3-13 March 2003) made by the DAC review team.

Box 10. The Vietnam field visit - A model for the future of Japanese ODA?

In spite of its natural endowment, Vietnam's 80 million people live in pervasive poverty. The country has a GDP per capital of USD 441 and one-third of its households are classified as poor. However, Vietnam's poverty rate is estimated to have fallen from 58% to 32% between 1993 and 2000, with the majority of the poor now located in the more isolated, rural parts of the country. Particularly since the adoption of its policy of Doi Moi ("renovation") in 1986, Vietnam has been on the course of economic growth, with a GDP that grew by over 6% per year in the 1990s. This growth has been driven by increasingly market-led economic policies, rising exports and foreign investment.

Vietnam's Doi Moi policy led it to seek out new partners in the early 1990s, and Japan was the first and most responsive. Initial Japanese ODA loans were provided in 1992 as a form of commodity loan. Japan co-sponsored, with the World Bank, a first donor conference on Vietnam (1993) where it also set the tone by announcing major bilateral funding, especially in infrastructure. Japanese ODA to Vietnam has grown continuously over the last decade and today is the largest donor (USD 850 million per year) with responsibility for 40% of the country's total ODA. Co-ordination among the large number of foreign donors working in Vietnam was facilitated recently through the establishment of a Comprehensive Poverty Reduction and Growth Strategy (CPRGS), an innovative PRSP document that provides Vietnam's partners with a common sense of strategic vision for growth with equity. It also has led to the creation of key sector forums for operational collaboration, of which the semi-annual Consultative Group process is another part.

The large size of its programme, the favourable working environment of Vietnam, and the relative proximity to Japan have caused the Hanoi mission to be used as a testing ground for management reforms that support future decentralisation of overall Japanese development co-operation. An initial action in this respect was the creation in 2003 of an all-Japan "ODA Task Force" team that regrouped the official Japanese agencies under the leadership of the embassy's minister. This Task Force is currently undertaking a joint elaboration of a new Vietnam CAP, built around the three CPRGS pillars: (i) promotion of economic growth, (ii) improvement of social living conditions, and (iii) institution building. This all-Japan shared strategy and sector organisation could become a framework for increasingly collaborative relationships among the different agencies. Because Japanese strategic priorities have been chosen so as to coincide with the strategic priorities of the CPRGS, the all-Japan team also will have a basis for operational co-ordination with other partners working in the same sectors. If such a simply defined, coherent and decentralised operational system can be put in place, it can be expected to invite a reassessment of the division of responsibility between Tokyo and Hanoi.

Tanzania (see Box 11) is also seen as a pilot country for the testing of new ODA principles and organisation. As in Vietnam, this has been facilitated by the Tanzanian leadership in setting up structures for strategic and operational co-ordination, essentially built around the PRSP process. Because the current CAP preceded the PRSP, it does not refer directly to it, and neither the Tanzanian government nor the local civil society played an important role in drawing it up. Japan recognises these weaknesses and will redress them in the next CAP design. As Japan works to address the challenges of this more collaborative form of development co-operation, it does not hesitate to state openly its interest in moving from past approaches to ones built around the more strategic concept of "comprehensive efforts for each development subject".[48] A major evaluation of the current CAP helped Japan to direct its research for new directions, including creative thinking in the areas of partner co-ordination, greater emphasis on sector approaches and more emphasis on sustainability.

48. See "The Country Program Evaluation Study on JICA's Cooperation in Tanzania", International Development Center of Japan, March 2001.

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Box 11. The Tanzania field visit - The different context of Africa

Tanzania was Japan's 9th top ODA recipient in 2001, and the largest in Africa, in terms of gross ODA disbursement at USD 260 million. Even subtracting the USD 200 million of this total used for debt relief (largely for commercial loans), Japan remained one of Tanzania's top four donors. Japan has been co-operating with Tanzania since its independence and has designated it as one of the pilot countries to enhance donor co-ordination. Both the Embassy and JICA have increased staff for this purpose.

Japan produced a CAP Tanzania in 2000, the orientations of which were: 1) promotion of agriculture and small-scale industries; 2) basic education; 3) basic health care, including HIV/AIDS prevention; 4) urban infrastructure; and 5) forest conservation. Even though it was written before the Tanzanian PRSP, the strategic directions of Japan overlap with those of the PRSP, except for the contract between the Japanese emphasis on urban infrastructure, versus the Tanzanian infrastructure emphasis on rural roads.

Uncertainties over the most appropriate activities to promote, when coupled with the weak absorptive capacity and management environment of Tanzania, has led Japan to move gradually from past policies that focused on loan assistance, in favour of grant assistance and a lesser emphasis on large infrastructure, more collaboratively designed strategy and projects, and a willingness to experiment with new approaches in Tanzania. Japan's efforts are bearing fruit and both the Government of Tanzania and other donors expressed appreciation for the collaborative nature of Japanese operations. In particular, Japan has provided a secretariat to lead donor co-ordination in the agriculture sector, played a significant role in the poverty monitoring activities for the PRSP, and has contributed to the Poverty Reduction Budget Support - the first time Japan has ever carried out direct budget support - using grants related to debt relief.

Whether emphasising principles of "self-help" or "cost-sharing", Japanese ODA leadership in the field is coming to see development co-operation programmes in a context of responsibility sharing, built around the leadership of the recipient country. This policy-level stress on ownership can be defined nevertheless in more than one way. In the case of Vietnam, Japanese emphasis is actively being placed on strategic collaboration, while in Tanzania the approach refers to a more operational form of demand-driven projects that appears to reflect the interests and priorities of individual ministries. The Peer Review took special note of the longer-term potential for tension inside the Japanese system between strong field statements in favour of local ownership in the recipient country and the range of Japanese domestic interests that have been recently reinforced in the new ODA Charter. It will undoubtedly be an ongoing challenge for the ODA Task Force team in the field to navigate a middle ground between these two potentially conflicting sets of interests.

Field organisation and staffing

ODA field organisation in Vietnam and Tanzania appears to be a series of vertically organized agencies with separate lines of command to Tokyo. Such compartmentalised behaviour comes with a range of transaction costs that merits greater analysis and attention in Tokyo, particularly as Japanese ODA leadership seeks to promote greater decentralisation. The ODA Task Force concept that is currently in its earliest stages of development in Vietnam and elsewhere could become an important innovation in this respect. If this team approach can foster internal Japanese co-ordination around a common vision, it has the potential to build synergies among agencies and set the basis for even more effective organisational reforms (*e.g.* more optimal integration of grants, technical co-operation and loans; improved co-ordination between headquarters and the field).

The **staff** in both Vietnam and Tanzania appear to be organised and dedicated, albeit over-worked. In Vietnam, 47 Japanese and local professional staff are currently employed by the different agencies of the ODA Task Force (11 work for the Embassy, 28 for JICA, 8 for JBIC). There are 20 professionals working in Tanzania, (5 for the Embassy, 10 for JICA, plus 5 national programme

officers). However, because the current system maintains key decision-making in Tokyo, the profile of many professional field staff was not one of extensive development-specific skills or experience, particularly the local staff and those seconded from sector ministries in Japan. A common complaint heard in Tokyo was the difficulty of increasing the numbers of development staff in the field given the current context of government-wide personnel compression. In Vietnam, the total of 47 professionals for an annual country programme of USD 850 million appeared proportionately smaller size than most donors in country.[49] In Tanzania, the Japanese programme relied on a total of 20 professionals for a programme of USD 260 million, but of which some USD 200 million is in the less management-intensive areas of debt relief. The prevalent opinion of Japanese management in the field was that the current number of professional staff and their skill levels should increase. More importantly, perhaps, the fact that the existing configuration of Japanese ODA staff is construed around an agency, rather than team management concept, suggests that significant efficiencies could be gained from a greater operational collaboration across agencies and the increased synergy that would result. Field staff roles, depending on the agency, tend to be biased toward general co-ordination and administrative support tasks (*e.g.* sector-oriented general oversight for Embassy development staff, largely composed of seconded staff from Tokyo ministries; JICA general support responsibilities for large numbers of technical co-operation experts located in the host country ministries; selected monitoring and decision making for ongoing ODA loan projects, research activities and information collection for JBIC operations officers). In the case of Tanzania, the need to be more fully linked to ongoing donor learning processes led to the allocation of some extra staff to the Embassy and the JICA mission. In Vietnam, the availability of skilled local professionals has meant greater reliance could be placed on local Vietnamese contract staff.

Country implementation: New approaches on the horizon

Consistent with the new directions of organisation and management change reviewed in Chapter 5, several new approaches (all in the early stages of implementation) were noted in Vietnam and Tanzania. Following the innovative leadership of local authorities in these countries, Japan and other partners have begun to establish an important repertory of lessons learned for development co-operation more broadly.

Decentralised co-ordination in the PRSP context

Both Vietnam and Tanzania were countries with a well advanced PRSP process which has helped Japan undertake more efficient co-ordination of strategy and implementation. In both cases, Japan supported the PRSP processes, at times with funding and technical assistance. The approach in Vietnam of careful partner co-ordination at the strategic level would appear to have been generally effective in eliciting recipient country ownership. In both the case of Vietnam and Tanzania, it can be assumed that Japanese (and other donor) programmes and implementation will be progressively better co-ordinated in the context of the PRSP sector working committees over time.

The PRSP framework offers new opportunities for Japanese portfolio development, including local operational linkages for the ODA Task Force. In Vietnam, this can permit the Japanese system to work more efficiently by establishing increasingly explicit linkages with the CPRGS sector co-ordinating groups, and thereby simultaneously linking up with the groups' mutual learning process and

49. In contrast, although not strictly comparable, the local World Bank office employed 95 professionals for a portfolio size of USD 750 million. The Asian Development Bank office, which depends heavily on Manila for technical support, employed 12 professional staff for a portfolio of slightly over USD 200 million.

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common policy dialogue process. To the extent it wishes to do so, this will also offer Japan an opportunity to play a stronger leadership position within the partner groups.

Implementation modalities

Japan continues to organise the implementation of its programmes mainly on a **project** basis. However, in principle, it remains open to whatever modality seems to make the most sense according to field realities, including sector programmes. In Tanzania, Japanese assistance is increasingly co-ordinated through local sector working groups; and in particular, Japan is the leading donor in the agriculture sector programme. In Vietnam, the new CAP is being explicitly organised along sector lines that are linked to the local CGPRS and will presumably be actively co-ordinated through implementation in that manner.

The topic of **budget support** is actively discussed within the Japanese system of development co-operation. There is no legal obstacle to the selected use of budget support, and although Japan is seen by some as being averse to use it in its operations, it is important to note that it has provided significant amounts of non-project grant assistance and sector programme loans, commodity loans, structural adjustment programme loans etc. over the last 40 years, largely in the form of balance of payments support. As a matter of preference, Japan (as with other donors) remains concerned by the accountability issues of using taxpayer funds in a context of poor financial management and potential corruption often found in the developing world. Japan also wants to avoid paying for recurrent costs of government and even requires that most local costs should be covered by the recipient country. Japan is encouraged to continue to actively participate in the current donor discussion over the appropriateness of the new forms of budget support (*e.g*. basket funding, performance based general budget support) that are being attempted by some DAC members. It is further suggested that Japanese ODA leadership in its pilot missions should be given the authority to participate in these schemes, should they seem locally appropriate. As mentioned earlier, in Tanzania, where the practice is fairly widespread within the donor community, Japan contributed to budget support targeted on poverty and was contemplating participation in basket funding for the agriculture sector (see Box 12).

Field approaches to monitoring and evaluation

Current field approaches to monitoring and evaluation are very much determined by the overall feedback system described in Chapter 5. Field monitoring across agencies at the project level is driven by the contractors hired to provide technical assistance, especially for technical and grant assistance. This monitoring information is shared directly with host country and subsequently with Japanese official staff, who appear to play a relatively modest role in guiding implementation once the contracts have been signed. Regarding ODA loans, projects are monitored by JBIC field staff, including locally employed staff and several types of external specialists. Evaluation, on the other hand, is largely driven by Tokyo, who may organise field work through contracting with specialists or through internally led efforts, sometimes in collaboration with the host country government. In terms of reporting on the MDGs, Japanese leadership in both Vietnam and Tanzania see the logical source of this information at the level of the country PRSP. In both countries, Japan has attempted to support the enhancement of PRSP capacity to measure the impact of donor programmes in this area. At the same time, monitoring and evaluation are still fragmented along instrumental and organisational lines and lack a comprehensive overview for the entire country programme. As the decentralisation thinking evolves, this is an aspect that warrants review and rethinking by Tokyo.

One area Japan could also develop is a system to assess performance of multilateral organisations in the field, synthesise the information systematically, and reflect them in Japan's position in the board meetings of the respective multilateral organisations. Some Japanese embassies such as that of

Tanzania currently reports activities of multilaterals to Tokyo, but not to the degree of active performance assessment. In contrast, since the 1980s the US has established a world-wide "Early Warning System" that shares World Bank project proposals in advance of its review by the Bank's board. The proposals are e-mailed to the appropriate United States Agency for International Development (USAID) mission which then co-ordinates with other relevant specialists in the country before returning field observations and suggestions to the US Executive Director's office via USAID headquarters. As one of the largest contributors to many organisations, Japan could also become more actively involved in shaping the policies and good governance of multilateral organisations through an enhanced feedback mechanism from the field. To this end, sufficient integration of the multilateral and bilateral efforts is necessary to create a more systematic learning process and to ensure that Japan's positions are consistent with each other.

Harmonisation and aid effectiveness viewed from the field

Japanese ODA leadership supports the objectives outlined in the 2003 DAC report "Harmonising Donor Practices for Effective Aid Delivery". Japan explicitly bases its rationale for pursuing a policy of harmonisation as being supportive of the objective of enhancing the effectiveness of its aid. It actively participated in OECD/DAC harmonisation discussions[50] and subsequently co-sponsored a regional workshop on the topic in Hanoi before carrying the messages of harmonisation to the 2003 High-level Forum in Rome. The specific focus of Japanese policy is on the harmonisation of procedures of aid delivery. Japan has explicitly stated its view that the debate over harmonisation of aid modalities is contrary to the spirit of using flexibility in dealing with the field realities of individual countries, although it is not necessarily against such a concept if it makes sense in certain circumstances. Japan is encouraged to continue working with other donors on the debate on harmonisation.

Japan uses the DAC system of classifying harmonisation efforts into three separate themes. First, in working **between donors and partner governments**, Japan emphasises the fundamental importance of ensuring partner country ownership and leadership. For Japan, this requires both the alignment of donor activities with partner-owned development plans (*e.g.* PRSP) and an investment in the building of local capacity. Japan specifically cites its experience on loan procedures in Vietnam (see Box 12) as an example of harmonisation. Secondly, in working **between donor agencies**, Japan is conscious of the need to reduce the heavy transaction costs exacted by complex donor requirements and wishes to harmonise procedures in collaboration with other donors so as to reduce these costs on a progressive and pragmatic basis, starting in the areas where marginal benefits are greatest. Japan has also stated its interest in each donor sharing country or sector analysis with others and, in this sense, is promoting information sharing through its participation in the Country Analytic Work website launched by the World Bank. In Vietnam, Japan is working in partnership with the United Kingdom to prepare a workshop on Aid Effectiveness. Thirdly, in working **within individual donor systems**, Japan has stated its determination to review its own aid procedures and systems to promote their further improvement and rationalisation.

50. Japan contributed to the Task Force on Donor Practices by funding a highly appreciated needs assessment of partner countries' efforts at harmonisation. Japan also holds the Vice Chairmanship of the DAC Working Party on Aid Effectiveness and Donor Practices.

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Box 12. Loan harmonisation in Vietnam: the "Five Development Banks"

In Vietnam, three development banks (ADB, JBIC, World Bank), agreed at a May 2002 mid-year Consultative Group meeting to undertake an effort to harmonise their procedures and practices in the areas of procurement, financial management, environmental safeguards, portfolio management and economic-social work. Their joint effort has begun to bear results over the first year and is considered by some as being among the leading examples of donor harmonisation in the world. A Joint Portfolio Performance Review held with the Vietnamese government in May 2003 noted initial gains since the 2002 agreement, including progress toward objectives and an improvement in the rate of disbursement by over 10%. In light of this progress, two more bilateral development banks, those of France and Germany, have joined the effort, which now cumulatively represents over 70% of all concessional lending in Vietnam.

One of the early lessons learned by the Group was to focus on a few key tasks rather than to attempt to resolve all issues simultaneously. In support of this logic, the Group is now focused on the two themes of (i) procurement and disbursement planning and, (ii) reporting systems, for which a mutually acceptable action plan and common format are now being drafted. The Group soon hopes to invite greater integration of the Vietnamese Government procedures into this harmonisation process.

In addition to the pilot work of the "Five Development Banks" group in Vietnam by JBIC, JICA has participated on a local task force on harmonisation. JBIC has also initiated a pilot programme with the ADB in Indonesia which seeks to standardise documentation in procurement, financial management and environment, and is attempting similar initiatives in the Philippines and Jamaica. At the same time, the Japanese approach to **tying ODA grants** has been a challenge in the harmonisation effort (see Box 13). The DAC encourages Japan to re-examine the necessity of this type of procedure.

Box 13. The special issue of Japanese contractors and the untying of grant aid

Operational grants are tied to Japanese primary contractors. However, the contractors are subsequently under no legal obligation subsequently to procure Japanese goods, services or works. Therefore, MOFA considers the grants to be untied and reports them as such to the DAC. According to MOFA, grants are tied to Japanese primary contractors to ensure that the requirements of the Japanese budget process are being respected. The Japanese budget system has little flexibility to carry over funds from one fiscal year to the next and, it is asserted, only Japanese companies can ensure the procurement of project-related goods, services and works before the end of the fiscal year. Japan believes that this required use of Japanese primary contractors ensures a greater attention to the quality and durability of its investments.

This requirement raises a number of questions at the level of the DAC. First, it is interesting to note the different approach for ODA loans. Here, when the primary contractor is tied to Japanese companies, such as for the Special Yen Loans after the Asian crisis, the loan is reported as tied, regardless of whether procurement for separate projects was untied. Second, the systematic use of Japanese contractors for grants raises questions concerning Japan's commitment to the principles of country ownership, partnership, and harmonisation of donor procedures. Although the partner government is invited to Tokyo to participate in choosing the Japanese primary contractor, and is consulted on the specifications for the procurement of goods and services, it is nevertheless also true that the partner government does not carry the main responsibility for procurement. Similarly, if the use of Japanese contractors relates to Japanese internal requirements, it should be possible to re-examine this approach in the spirit of better aligning donor procedures to partner country systems. Finally, the DAC notes that tying of operational grants to Japanese primary contractors is also applied for grants to the LDCs. This clearly implies that the 2001 DAC Recommendation on Untying ODA to the LDCs has had little practical effect on Japan's procurement system for LDC grants.

Future considerations

- Japan should replicate the Vietnam and Tanzania decentralisation experiences elsewhere, particularly concerning the creation of an ODA Task Force and the emphasis on co-ordination, harmonisation and sector leadership.

- Japan should continue its growing involvement in the current donor discussions on budget support, contributing its recent experience in Tanzania.

- An enhanced feedback mechanism from the field on assessing multilateral performance should be developed.

- Japan should work with the DAC on identifying concrete measures to untie progressively the use of grant funds for primary contractors, in the spirit of the Recommendation on Untying ODA to the least-developed countries.

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ANNEX A

THE 1999 DAC PEER REVIEW AND JAPAN'S ACHIEVEMENTS

Key issues	Concerns expressed in 1999	Progress achieved
Volume of aid	Japan should maintain and increase its ODA volume.	Due largely to the weak Japanese national budget, net ODA volume dropped sharply in 2001 and continued to drop in 2002-2003.
ODA administration	ODA administration should be strengthened, including staffing, increasing the roles of implementing agencies, decentralisation of field offices, improved aid co-ordination, and enhancement of NGO involvement.	Some reforms are underway, including: a stronger role for MOFA to co-ordinate the ODA institutions; a more independent operational status for JICA; greater support for NGOs; pilot efforts to decentralise to the field level.
Strategic framework	A new medium-term policy statement for ODA will provide a basis for the re-orientation of Japan's aid policies and management, in line with the new International Development Strategy (IDS). Country assistance strategies should be prepared in accordance with the IDS and with participation by recipient countries, other donors, and NGOs; country strategy design teams should be sensitised to the IDS before they go out to the field; and lessons learned from the seven IDS pilot countries should be mainstreamed in the overall ODA programme.	Japan revised its ODA charter in August 2003. Japan has been striving to make ODA more coherent with IDS objectives. The new Charter also makes greater use of Country Assistance Programmes (CAP) and a formal medium-term policy statement. CAPs have been prepared for 15 countries and have involved participation of civil society.
Effect of organisational reform	It will be important for the integrity of ODA to be preserved within the OECF/JEXIM merger, particularly through separate policies and accounts.	JBIC uses an administrative "firewall" to separate the two functions.
Lessons learned from Asian crisis	There needs to be an analysis of the domestic roots and the implications of the Asian crisis, including the sustainability of "economic take-off", "self-help efforts", governance and corruption, and institutional and human capacity development.	Japan has yet to officially elaborate on the findings.
Mainstreaming of cross-cutting issues	Cross-cutting issues such as poverty, gender and governance should be mainstreamed, with clear definitions for "basic human needs", "the poor", "poverty", and "poverty reduction".	Japan still lacks a mechanism that cuts across institutional boundaries to deal with cross-cutting issues. Approaches to these issues currently vary significantly from one ODA institution to another.
Effectiveness, sustainability, and policy dialogue	Projects should be designed, monitored, and evaluated with a view towards cost-effectiveness, sustainability, technological appropriateness, and socio-economic outcome/impact. Policy dialogue should be given more emphasis.	Project processes have not changed significantly. Reduction of cost is a major factor in the current environment of budget restraint. Sustainability is primarily addressed as a question of policy, and includes greater interest in ownership, CAPs and decentralisation of Japanese institutions to the field. Policy dialogue is being given additional emphasis.

Policy coherence	Coherence between development co-operation and other economic policies of Japan affecting trade and investment vis-à-vis developing countries needs to be systematically promoted.	Japan does not have an explicit statement on policy coherence for development. It also lacks an analytical capability to identify, and propose solutions for, issues of incoherence.
Untying of aid	Japan is encouraged to further promote untying of its ODA, particularly to least developed countries, bearing in mind also the DAC's work in this area.	Japanese grants for LDCs are not yet fully untied.

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ANNEX B

JAPAN'S OFFICIAL DEVELOPMENT ASSISTANCE CHARTER

August 29, 2003
Government of Japan
Ministry of Foreign Affairs
Economic Co-operation Bureau

(Unofficial translation)

Revision of Japan's Official Development Assistance Charter

Japan's Official Development Assistance (ODA) Charter, approved by the Cabinet in 1992, has been the foundation of Japan's aid policy for more than 10 years. The world has changed dramatically since the Charter was first approved, and today there is an urgent need for the international community, including Japan, to address new development challenges such as peace-building. Faced with these new challenges, many developed countries are strengthening their ODA policy, to deal with the serious problems that developing countries face. At the same time, not only governments and international organisations, but many other stakeholders are also assisting developing countries. All stakeholders engaged in development assistance are strengthening their mutual collaboration.

In line with the spirit of the Japanese Constitution, Japan will vigorously address these new challenges to fulfil its responsibilities commensurate with its national strength and its standing in the international community. In this regard, it is important to have public support for ODA. It is essential to effectively implement ODA, fully taking into account the domestic economic and fiscal situation as well as the views of the Japanese people.

Against this background, the Government of Japan has revised the ODA Charter, with the aim of enhancing the strategic value, flexibility, transparency, and efficiency of ODA. The revision also has the aim of encouraging wide public participation and of deepening the understanding of Japan's ODA policies both within Japan and abroad.

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Japan's Official Development Assistance Charter

I. Philosophy: Objectives, Policies, and Priorities

1. Objectives

The objectives of Japan's ODA are to contribute to the peace and development of the international community, and thereby to help ensure Japan's own security and prosperity.

Taking advantage of Japan's experience as the first nation in Asia to become a developed country, Japan has utilized its ODA to actively support economic and social infrastructure development, human resource development, and institution building. Consequently, Japan has significantly contributed to the economic and social development of developing countries, especially in East Asia.

Amid the post-Cold War advancement of globalization, the international community presently finds itself in a new environment, grappling with a multiplicity of problems such as the gap between the rich and the poor; ethnic and religious conflicts; armed conflicts; terrorism; suppression of freedom, human rights, and democracy; environmental problems; infectious diseases; and gender issues.

In particular, humanitarian problems, such as extreme poverty, famine, refugee crises, and natural disasters, as well as global issues such as those related to the environment and water, are important issues that need to be addressed in order for the international community as a whole to achieve sustainable development. These problems are cross border issues that present a grave threat to each and every human being.

Furthermore, conflicts and terrorism are occurring more frequently and they are becoming even more serious issues. Preventing conflicts and terrorism, and efforts to build peace, as well as efforts to foster democratization, and to protect human rights and the dignity of individuals have become major issues inherent to the stability and development of the international community.

Japan, as one of the world's leading nations, is determined to make best use of ODA to take the initiative in addressing these issues. Such efforts will in turn benefit Japan itself in a number of ways, including by promoting friendly relations and people-to-people exchanges with other countries, and by strengthening Japan's standing in the international arena.

In addition, as nations deepen their interdependence, Japan, which enjoys the benefits of international trade and is heavily dependent on the outside world for resources, energy and food, will proactively contribute to the stability and development of developing countries through its ODA. This correlates closely with assuring Japan's security and prosperity and promoting the welfare of its people. In particular, it is essential that Japan make efforts to enhance economic partnership and vitalize exchange with other Asian countries with which it has particularly close relations.

Japan aspires for world peace. Actively promoting the aforementioned efforts with ODA, and manifesting this posture both at home and abroad is the most suitable policy for gaining sympathy and support from the international community for Japan's position. Therefore, Japan's ODA will continue to play an important role in the years to come.

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2. Basic Policies

In order to achieve the objectives outlined above, Japan will carry out ODA even more strategically, in accordance with the following basic policies.

(1) Supporting self-help efforts of developing countries

The most important philosophy of Japan's ODA is to support the self-help efforts of developing countries based on good governance, by extending cooperation for their human resource development, institution building including development of legal systems, and economic and social infrastructure building, which constitute the basis for these countries' development. Accordingly, Japan respects the ownership by developing countries, and places priorities on their own development strategies.

In carrying out the above policy, Japan will give priority to assisting developing countries that make active efforts to pursue peace, democratization, and the protection of human rights, as well as structural reform in the economic and social spheres.

(2) Perspective of "Human Security"

In order to address direct threats to individuals such as conflicts, disasters, infectious diseases, it is important not only to consider the global, regional, and national perspectives, but also to consider the perspective of human security, which focuses on individuals. Accordingly, Japan will implement ODA to strengthen the capacity of local communities through human resource development. To ensure that human dignity is maintained at all stages, from the conflict stage to the reconstruction and development stages, Japan will extend assistance for the protection and empowerment of individuals.

(3) Assurance of fairness

In formulating and implementing assistance policies, Japan will take steps to assure fairness. This should be achieved by giving consideration to the condition of the socially vulnerable, and the gap between the rich and the poor as well as the gap among various regions in developing countries. Furthermore, great attention will be paid with respect to factors such as environmental and social impact on developing countries of the implementation of ODA.

In particular, the perspective of gender equality is important. Japan will make further efforts to improve the status of women, giving full consideration to the active participation of women in development, and to ensuring that women reap benefits from development.

(4) Utilization of Japan's experience and expertise

Japan will utilize its own experience in economic and social development as well as in economic cooperation when assisting the development of developing countries, fully taking into account the development policies and assistance needs of developing countries. Japan will also utilize its advanced technologies, expertise, human resource, and institutions.

Implementation of ODA will be coordinated with key Japanese policies to ensure policy coherence, taking into consideration implications for Japan's economy and society.

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(5) Partnership and collaboration with the international community

Mainly with the initiative of international organizations, the international community is sharing more common development goals and strategies and various stakeholders are increasingly coordinating their aid activities. Japan will participate in this process, and endeavor to play a leading role. In parallel with such efforts, Japan will pursue collaboration with United Nations organizations, international financial institutions, other donor countries, NGOs, private companies, and other entities. In particular, Japan will enhance collaboration with international organizations that possess expertise and political neutrality, and will endeavor to ensure that Japan's policies are reflected appropriately in the management of those organizations.

In addition, Japan will actively promote South-South cooperation in partnership with more advanced developing countries in Asia and other regions. Japan will also strengthen collaboration with regional cooperation frameworks, and will support region-wide cooperation that encompasses several countries.

3. Priority Issues

In accordance with the objectives and basic policies set out above, the following are Japan's priority issues.

(1) Poverty reduction

Poverty reduction is a key development goal shared by the international community, and is also essential for eliminating terrorism and other causes of instability in the world. Therefore, Japan will give high priorities to providing assistance to such sectors as education, health care and welfare, water and sanitation and agriculture, and will support human and social development in the developing countries. At the same time, sustainable economic growth, increase in employment, and improvement in the quality of life are indispensable for realizing poverty reduction and Japan places importance on providing assistance for these issues accordingly.

(2) Sustainable growth

In order to invigorate developing countries' trade and investment, as well as people-to-people exchanges, and to support sustainable growth, Japan will place importance on providing assistance for the development of the socioeconomic infrastructure - a key factor for economic activity, and also for policy-making, the development of institutions, and human resource development. This will include (i) cooperation in the field of trade and investment including the appropriate protection of intellectual property rights and standardization, (ii) cooperation in the field of information and communications technology (ICT), (iii) the acceptance of exchange students, and (iv) cooperation for research.

In addition, Japan will endeavor to ensure that its ODA, and its trade and investment, which exert a substantial influence on the development of recipient countries, are carried out in close coordination, so that they have the overall effect of promoting growth in developing countries. To that end, Japan will make efforts to enhance coordination between Japan's ODA and other official flows such as trade insurance and import and export finance. At the same time, private-sector economic cooperation will be promoted, making full use of private-sector vitality and funds.

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(3) Addressing global issues

As for global issues such as global warming and other environmental problems, infectious diseases, population, food, energy, natural disasters, terrorism, drugs, and international organized crime, further efforts must be given immediately and in a coordinated manner by the international community. Japan will address these issues through ODA and will play an active role in the creation of international norms.

(4) Peace-building

In order to prevent conflicts from arising in developing regions, it is important to comprehensively address various factors that cause conflicts. As part of such undertakings, Japan will carry out ODA to achieve poverty reduction and the correction of disparities, as referred to above. In addition to assistance for preventing conflicts and emergency humanitarian assistance in conflict situations, Japan will extend bilateral and multilateral assistance flexibly and continuously for peace-building in accordance with the changing situation, ranging from assistance to expedite the ending of conflicts to assistance for the consolidation of peace and nation-building in post-conflict situations.

For example, ODA will be used for: assistance to facilitate the peace processes; humanitarian and rehabilitation assistance, such as assistance for displaced persons and for the restoration of basic infrastructure; assistance for assuring domestic stability and security, including disarmament, demobilization, and reintegration of ex-combatants (DDR), and the collection and disposal of weapons, including demining; and assistance for reconstruction, including social and economic development and the enhancement of the administrative capabilities of governments.

4. Priority Regions

In light of the objectives stated above, Asia, a region with close relationship to Japan and which can have a major impact on Japan's stability and prosperity, is a priority region for Japan. However, Japan will strategically prioritize assistance to Asian countries, fully taking into account the diversity of the Asian countries' socioeconomic conditions and changes in their respective assistance needs. In particular, the East Asian region which includes ASEAN is expanding and deepening economic interdependency and has been making efforts to enhance its regional competitiveness by maintaining economic growth and strengthening integration in recent years. ODA will be utilized to forge stronger relations with this region and to rectify disparities in the region, fully considering such factors as the strengthening of economic partnership with East Asian countries.

Also, Japan will give due consideration to the large population of impoverished people in South Asia. With respect to Central Asia and the Caucasus region, assistance will be provided to promote democratization and transition to market economies.

Japan will prioritize its assistance for other regions on the basis of the objectives, basic policies, and priority issues set out in this Charter, giving consideration to the needs for assistance and the state of development in each region.

Africa has a large number of least developed countries, and is affected by conflicts and serious development issues, amid which self-help efforts are being stepped up. Japan will provide assistance for these efforts.

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The Middle East is an important region for energy supply and for the peace and stability of the international community, but it has destabilizing factors including the situation of Middle East peace process. Japan will provide assistance towards social stability and the consolidation of peace.

Latin America includes countries that are relatively well developed, but also island nations with fragile economies. Taking into consideration the disparities arising within the region as well as within countries, Japan will extend the necessary cooperation.

With respect to Oceania, assistance will be provided, as there are numerous vulnerable island nations.

II. Principle of ODA Implementation

In line with the philosophy set out above, Japan's ODA will be provided by comprehensively taking into account developing countries' need for assistance, socio-economic conditions, and Japan's bilateral relations with the recipient country, and ODA will be provided in accordance with the principles of the United Nations (especially sovereign equality and non-intervention in domestic matters) as well as the following points:

(1) Environmental conservation and development should be pursued in tandem.

(2) Any use of ODA for military purposes or for aggravation of international conflicts should be avoided.

(3) Full attention should be paid to trends in recipient countries' military expenditures, their development and production of weapons of mass destruction and missiles, their export and import of arms, etc. so as to maintain and strengthen international peace and stability, including the prevention of terrorism and the proliferation of weapons of mass destruction, and from the viewpoint that developing countries should place appropriate priorities in the allocation of their resources on their own economic and social development.

(4) Full attention should be paid to efforts for promoting democratization and the introduction of a market-oriented economy, and the situation regarding the protection of basic human rights and freedoms in the recipient country.

III. Formulation and Implementation of ODA Policy

1. System of Formulation and Implementation of ODA Policy

(1) Coherent formulation of ODA policy

In order to ensure that the government in its entirety implements ODA efficiently and effectively in a unified and coherent manner pursuant to this Charter, medium-term ODA policies and country assistance programs will be formulated, taking into account the partnership and collaboration with the international community referred to in the Basic Policies and ODA policies will be formulated and implemented in accordance with them. Country assistance programs will be drawn up for major recipient countries, and will set out explicitly the points to which priority is to be given, based on Japan's aid policy, and reflecting the recipient countries' true assistance needs.

In accordance with these medium-term ODA policies and country assistance programs, various methods of assistance - financial cooperation in the form of loans and grants, and technical cooperation - will be linked together effectively so as to take full advantage of the characteristics of

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each method. At the same time, Japan will be mindful of the balance between hardware type cooperation such as construction and provision of equipment, and software type cooperation such as technical cooperation and institution building. Each method will be reviewed appropriately.

(2) Collaboration among related government ministries and agencies

In order to ensure that the government as a whole formulates and implements policies in a unified and coherent manner, under the auspices of the Council of Overseas Economic Cooperation-Related Ministers, the Ministry of Foreign Affairs will play the central coordinating role in strengthening broad collaboration between the ODA-related government ministries and agencies, including by means of personnel exchanges and by utilizing the expertise of those related ministries and agencies. For this purpose, the government ministries and agencies will actively use consultation fora such as the Inter-Ministerial Meeting on ODA.

(3) Collaboration between government and implementing agencies

While making clear the roles of the government and the implementing agencies (the Japan International Cooperation Agency* and the Japan Bank for International Cooperation) and the apportionment of responsibilities among them, collaboration will be strengthened, including by means of personnel exchanges to ensure an organic linkage between the government and the implementing agencies. In addition, implementing agencies will strengthen their mutual collaboration.

(4) Strengthening of policy consultation

In formulating and implementing assistance policies, it is essential to fully grasp the development policies and assistance needs of developing countries by engaging actively in policy consultation before requests are made by developing countries. At the same time, Japan will set out its assistance policies to the developing countries through dialogue, and the development policies of developing countries and Japan's assistance policy will be reconciled in order to maximize the effect of Japan's aid within those developing countries' development strategies. Furthermore, Japan will support efforts by developing countries to improve their policies and systems, including the ability to formulate and implement assistance projects. Japan will also take into consideration whether such efforts by the developing countries are sufficient in the formulation and implementation of ODA.

(5) Strengthening of the functions of field missions in the policy-making process and in implementation

The functions of field missions (primarily overseas diplomatic missions and offices of implementing agencies) will be strengthened, so that they will be able to play a leading role in the policy-making process and in implementation. In particular, steps will be taken to develop a framework for strengthening the system, including through the use of outside personnel. Japan will also make efforts to make comprehensive and accurate assessments of developing countries' development policies and assistance needs, primarily at the local level. Japan will comprehensively identify local socioeconomic conditions and other aspects through local interested parties.

(6) Collaboration with aid-related entities

Collaboration with Japanese NGOs, universities, local governments, economic organizations, labor organizations, and other related stakeholders will be strengthened to facilitate their participation in ODA and to utilize their technologies and expertise. Japan will also seek to collaborate with similar

entities overseas, particularly in developing countries. In addition, in the implementation of ODA, appropriate use will be made of the technologies and expertise of Japanese private companies.

2. Increasing public participation

(1) Broad participation by Japanese citizens from all walks of life

The government will take measures to foster participation in assistance activities by Japanese citizens from all walks of life, and to promote these citizens' interaction with developing countries. Such measures will include providing sufficient information, listening to public opinion, soliciting proposals for ODA activities, and extending cooperation to volunteer activities.

(2) Human resource development and development research

The government will make efforts to foster aid personnel with the necessary expertise and to increase the opportunities for aid personnel to be active both within Japan and overseas. In parallel with these efforts, high-quality personnel, such as persons with considerable overseas experience and extensive knowledge, will be widely sought and be encouraged to participate in ODA activities.

In addition, the government will encourage regional studies relating to developing countries and research on development policy, to promote accumulation of Japan's intellectual assets in the development sphere.

(3) Development education

Development education is important for promoting public understanding with respect to international cooperation including ODA, and for fostering people that will be engaged in international cooperation in the future. In this perspective, the government will take measures in schools and on other occasions to carry out more widespread education on development issues, such as the problems that face developing countries, relations between Japan and developing countries and the role that development assistance should play. Necessary educational materials will be distributed and teachers will be trained.

(4) Information disclosure and public relations

It is important for information on ODA policy, implementation, and evaluation to be disclosed widely and promptly to ensure the sufficient transparency, and for it to be publicized actively. Therefore, the government will use a variety of means to provide information in easy-to-understand formats, and to create opportunities for Japanese citizens to come into contact with ODA activities that Japan is undertaking.

In addition, the government will make enhanced efforts to disseminate information regarding Japan's ODA to developing countries as well as other donors.

3. Matters Essential to Effective Implementation

(1) Enhancement of evaluation

The government will carry out consecutive evaluations at all stages, i.e. *ex ante*, mid-term, and *ex post*, and evaluations at each level, *i.e.* policy, program, and project. Furthermore, in order to measure, analyze and objectively evaluate the outcome of ODA, third-party evaluations conducted by experts

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will be enhanced while the government undertakes policy evaluations. The evaluation results will be reflected in subsequent ODA policy-making and efficient and effective implementation.

(2) Ensuring appropriate procedures

The government will adopt procedures to ensure that full consideration is given to the environmental and social impact of implementation of ODA. The government will make efforts to conduct appropriate and efficient procurement with regard to quality and price. At the same time, while ensuring these aspects, the procedures will be simplified and accelerated.

(3) Prevention of fraud and corruption

The government will implement appropriate measures to ensure the transparency of the activity-selection and implementation process, and to prevent fraud, corruption, and improper diversion of aid. In addition, the government will make efforts to assure the appropriate use of funds by enhancing auditing, including through the introduction of external audits.

(4) Ensuring the safety of ODA personnel

Safeguarding the lives and personal safety of ODA personnel is a prerequisite for the implementation of ODA. The government will fully obtain security related information and will take appropriate measures.

IV. Reporting on the Status of Implementation of the Official Development Assistance Charter

The government will report the status of the implementation of the Official Development Assistance Charter in the "White Paper on Official Development Assistance (ODA)," which is reported annually to the Cabinet.

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* On October 1, 2003, the Japan International Cooperation Agency is due to be reorganized as an independent administrative institution, changing its status from that of a special public institution.

August 29, 2003

ANNEX C

OECD/DAC STANDARD SUITE OF TABLES

Table C-1. Total Financial flows

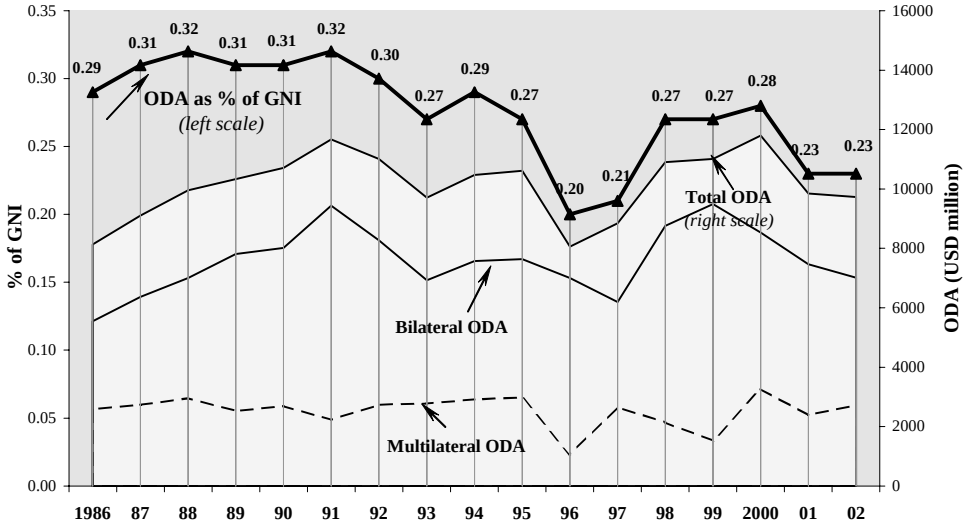
USD million at current prices and exchange rates

Net disbursements

Japan	1986-87	1991-92	1998	1999	2000	2001	2002
Total official flows	**5 222**	**14 149**	**23 451**	**23 260**	**8 746**	**8 426**	**4 278**
Official development assistance	6 488	11 052	10 640	12 163	13 508	9 847	9 283
Bilateral	4 490	8 622	8 553	10 476	9 768	7 458	6 692
Multilateral	1 998	2 429	2 087	1 687	3 740	2 389	2 591
Official aid	**n.a.**	**174**	**132**	**67**	**- 54**	**84**	**99**
Bilateral		96	94	27	- 93	25	56
Multilateral		78	39	40	39	59	43
Other official flows	**-1 266**	**2 924**	**12 678**	**11 030**	**-4 708**	**-1505**	**-5104**
Bilateral	-1 143	2 365	10 602	9 799	-4 456	-1524	-2592
Multilateral	- 123	558	2 076	1 231	- 252	19	-2 512
Grants by NGOs	**87**	**179**	**203**	**261**	**231**	**235**	**157**
Private flows at market terms	**11 073**	**6 128**	**50**	**-3 279**	**6 229**	**8 549**	**8 123**
Bilateral: *of which*	9 483	7 995	4 629	835	6 281	8 904	8 380
Direct investment	4 009	3 684	11 628	7 902	6 206	12 145	12 544
Export credits	640	- 226	-3 946	-2 305	- 356	783	-737
Multilateral	1 589	-1 867	-4 579	-4 114	- 52	- 355	- 257
Total flows	**16 381**	**20 457**	**23 703**	**20 242**	**15 206**	**17 210**	**12 558**
for reference:							
ODA (at constant 2001 $ million)	*8 614*	*11 339*	*10 900*	*11 011*	*11 797*	*9 847*	*9 732*
ODA (as a % of GNI)	*0.30*	*0.31*	*0.27*	*0.27*	*0.28*	*0.23*	*0.23*
Total flows (as a % of GNI) (a)	*0.75*	*0.57*	*0.45*	*0.39*	*0.23*	*0.34*	*0.18*

a. To countries eligible for ODA.

ODA net disbursements
At constant 2001 prices and exchange rates and as a share of GNI



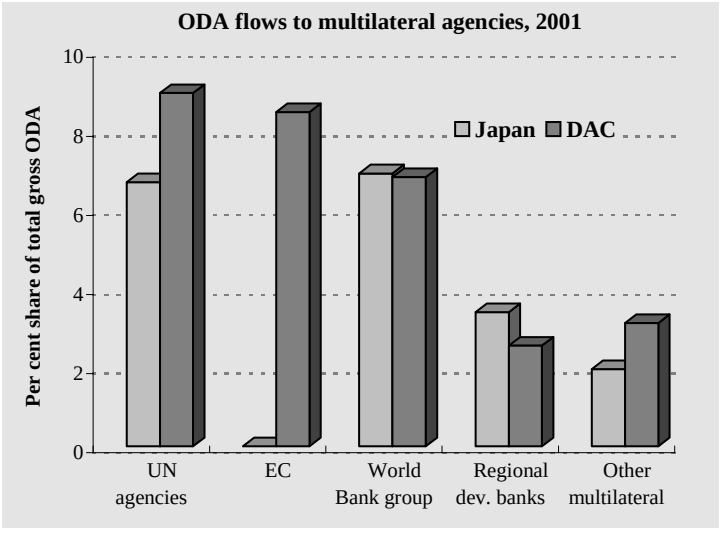
Source: OECD

Table C-2. ODA by main categories

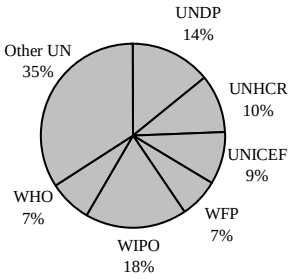
Disbursements

Japan	Constant 2001 USD million					Per cent share of gross disbursements					Total DAC
	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002	2001%
Gross Bilateral ODA	**11 359**	**12 180**	**10 969**	**10 236**	**10 105**	**84**	**89**	**77**	**81**	**79**	**70**
Grants	***5 020***	***4 957***	***4 959***	***4 742***	***4 584***	***37***	***36***	***35***	***38***	***36***	***57***
Project and programme aid	1 576	1 597	1 296	1 281	1 328	12	12	9	10	10	13
Technical co-operation	1 863	1 934	2 122	1 942	1 899	14	14	15	15	15	23
Developmental food aid	58	38	37	54	43	0	0	0	0	0	2
Emergency and distress relief	127	164	74	30	38	1	1	1	0	0	6
Action relating to debt	391	245	361	446	274	3	2	3	4	2	4
Administrative costs	673	694	814	715	734	5	5	6	6	6	5
Other grants	332	286	254	274	267	2	2	2	2	2	4
Non-grant bilateral ODA	***6 339***	***7 223***	***6 010***	***5 494***	***5 521***	***47***	***53***	***42***	***44***	***43***	***13***
New development lending	6 339	7 223	6 010	5 494	5 274	47	53	42	44	41	**12**
Debt rescheduling	-	-	-	-	247	-	-	-	-	2	**1**
Acquisition of equity and other	-	-	-	-	-	-	-	-	-	-	**0**
Gross Multilateral ODA	**2 138**	**1 527**	**3 266**	**2 389**	**2 716**	**16**	**11**	**23**	**19**	**21**	**30**
UN agencies	643	659	1 139	844	843	5	5	8	7	7	9
EC	-	-	-	-	-	-	-	-	-	-	8
World Bank group	827	146	1 007	871	1 178	6	1	7	7	9	7
Regional development banks (a)	483	478	778	428	412	4	3	5	3	3	3
Other multilateral	185	244	342	246	283	1	2	2	2	2	3
Total gross ODA	**13 497**	**13 707**	**14 236**	**12 625**	**12 821**	**100**	**100**	**100**	**100**	**100**	**100**
Repayments and debt cancellation	**-2 597**	**-2 696**	**-2 438**	**-2 778**	**-3 089**						
Total net ODA	**10 900**	**11 011**	**11 797**	**9 847**	**9 732**						
For reference:											
ODA to and channelled through NGOs	*329*	*295*	*251*	*272*	*248*						
Associated financing (b)	-	-	-	-	-						

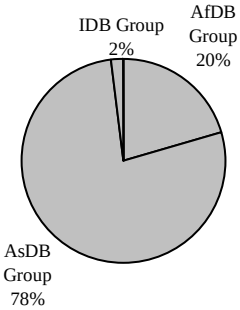
a Excluding EBRD.
b. ODA grants and loans in associated financing packages.



Contributions to UN Agencies (2001-02 Average)



Contributions to Regional Development Banks (2001-02 Average)



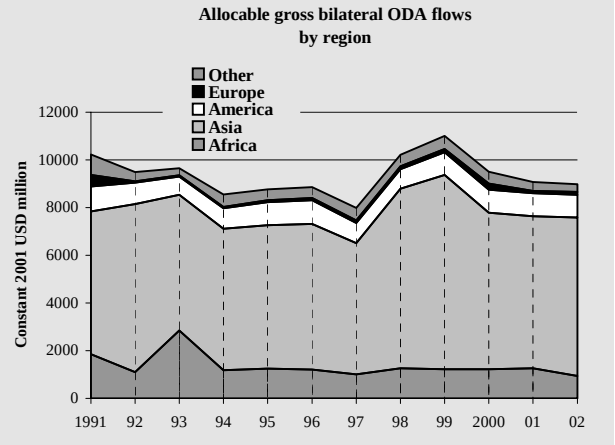
Source: OECD

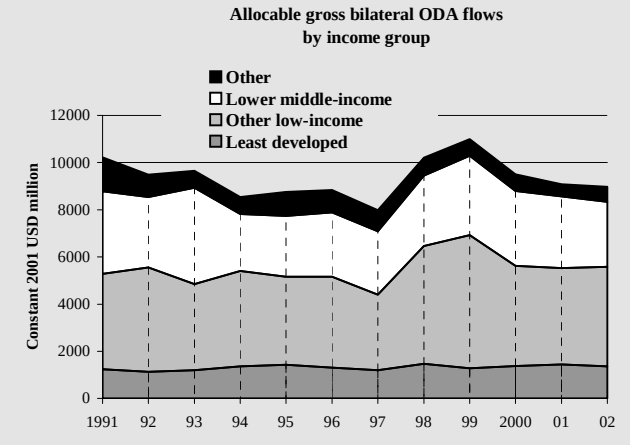
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Table C-3. Bilateral ODA allocable by region and income group

Gross disbursements

Japan	Constant 2001 USD million					Per cent share					Total DAC
	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002	2001%
Africa	1 249	1 226	1 221	1 250	930	12	11	13	14	10	**33**
Sub-Saharan Africa	1 056	982	936	930	722	10	9	10	10	8	**26**
North Africa	193	244	285	320	208	2	2	3	4	2	**7**
Asia	7 543	8 142	6 560	6 382	6 652	74	74	69	70	74	**39**
South and Central Asia	2 331	1 793	1 788	2 061	2 300	23	16	19	23	26	**17**
Far East	5 212	6 349	4 772	4 321	4 352	51	58	50	48	48	**22**
America	821	960	966	971	949	8	9	10	11	11	**15**
North and Central America	303	344	356	383	380	3	3	4	4	4	**7**
South America	518	616	610	588	568	5	6	6	6	6	**8**
Middle East	333	407	367	248	197	3	4	4	3	2	**4**
Oceania	153	134	136	126	120	1	1	1	1	1	**2**
Europe	117	129	257	99	133	1	1	3	1	1	**6**
Total bilateral allocable by country	**10 215**	**10 999**	**9 507**	**9 075**	**8 981**	**100**	**100**	**100**	**100**	**100**	**100**
Least developed	1 463	1 269	1 372	1 438	1 354	14	12	14	16	15	**26**
Other low-income	4 996	5 652	4 245	4 086	4 228	49	51	45	45	47	**33**
Lower middle-income	2 987	3 373	3 183	3 043	2 758	29	31	33	34	31	**35**
Upper middle-income	669	607	708	508	641	7	6	7	6	7	**5**
High-income	1	1	1	1	0	0	0	0	0	0	**0**
More advanced developing countries	99	98	-	-	-	1	1	-	-	-	-
For reference:											
Total bilateral	11 359	12 180	10 969	10 236	10 105	*100*	*100*	*100*	*100*	*100*	***100***
of which: Unallocated	*1 144*	*1 181*	*1 462*	*1 161*	*1 124*	*10*	*10*	*13*	*11*	*11*	***23***





Source: OECD

Table C-4. Main recipients of bilateral ODA

Gross disbursements, two-year averages

Japan	1991-92				1996-97				2001-02		
	Current USD million	Constant 2001 USD mn.	Per cent share		Current USD million	Constant 2001 USD mn.	Per cent share		Current USD million	Constant 2001 USD mn.	Per cent share
Indonesia	1 540	1 574	16	Indonesia	1 208	1 075	13	China	1 202	1 234	14
Philippines	946	954	10	China	963	860	10	India	841	862	10
China	874	887	9	Thailand	760	679	8	Thailand	758	775	9
India	775	805	8	India	741	664	8	Indonesia	748	764	8
Thailand	531	544	6	Philippines	714	640	8	Philippines	666	683	8
Top 5 recipients	**4 666**	**4 764**	**49**	**Top 5 recipients**	**4 385**	**3 918**	**47**	**Top 5 recipients**	**4 217**	**4 317**	**48**
Egypt	376	396	4	Malaysia	363	331	4	Viet Nam	429	438	5
Malaysia	310	319	3	Pakistan	327	290	3	Bangladesh	309	316	3
Jordan	285	298	3	Bangladesh	297	266	3	Pakistan	256	264	3
Peru	257	268	3	Sri Lanka	211	189	2	Sri Lanka	244	249	3
Turkey	251	266	3	Viet Nam	186	170	2	Brazil	171	175	2
Top 10 recipients	**6 145**	**6 310**	**64**	**Top 10 recipients**	**5 770**	**5 164**	**61**	**Top 10 recipients**	**5 626**	**5 760**	**64**
Korea	249	255	3	Egypt	163	145	2	Peru	170	174	2
Pakistan	227	231	2	Mexico	160	140	2	Tanzania	167	169	2
Bangladesh	220	224	2	Korea	153	134	2	Malaysia	147	151	2
Sri Lanka	205	213	2	Jordan	134	121	1	Azerbaijan	121	125	1
Viet Nam	186	184	2	Brazil	108	97	1	Cambodia	110	112	1
Top 15 recipients	**7 230**	**7 418**	**75**	**Top 15 recipients**	**6 489**	**5 802**	**69**	**Top 15 recipients**	**6 341**	**6 490**	**72**
Kenya	173	179	2	Kenya	101	90	1	Nepal	105	108	1
Nepal	120	124	1	Ghana	96	86	1	Tunisia	97	99	1
Zambia	115	118	1	Nepal	95	86	1	Morocco	86	88	1
Brazil	110	114	1	Myanmar	91	81	1	Honduras	86	88	1
Ghana	94	97	1	Mongolia	91	81	1	Laos	85	87	1
Top 20 recipients	**7 841**	**8 048**	**82**	**Top 20 recipients**	**6 963**	**6 225**	**74**	**Top 20 recipients**	**6 799**	**6 959**	**77**
Total (152 recipients)	**9 606**	**9 858**	**100**	**Total (158 recipients)**	**9 407**	**8 418**	**100**	**Total (144 recipients)**	**8 821**	**9 028**	**100**
Unallocated	729	747		Unallocated	1 308	1 177		Unallocated	1 116	1 142	
Total bilateral gross	**10 335**	**10 605**		**Total bilateral gross**	**10 715**	**9 595**		**Total bilateral gross**	**9 937**	**10 170**	

Source: OECD

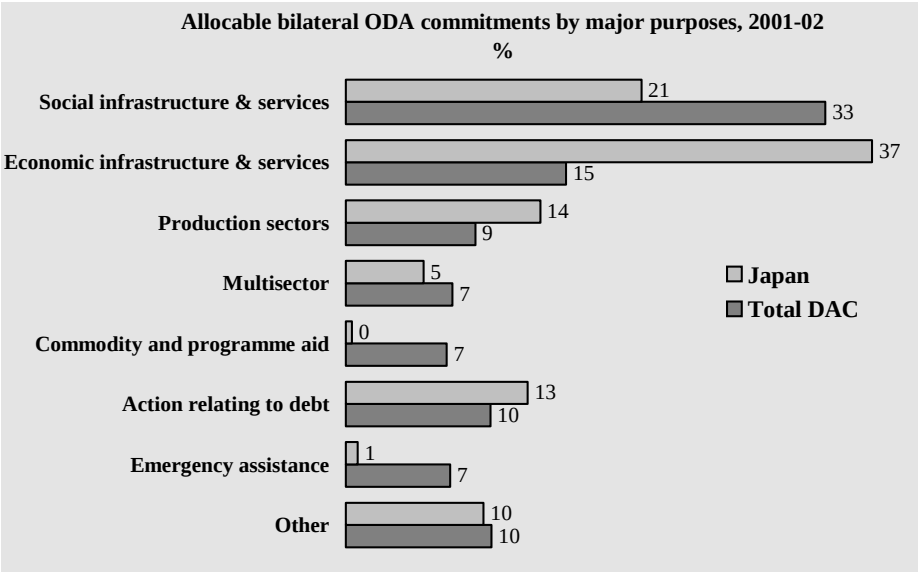
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Table C-5. Bilateral ODA by major purposes

at current prices and exchange rates

Commitments, two-year averages

Japan	1991-92		1996-97		2001-02		2001
	USD million	Per cent	USD million	Per cent	USD million	Per cent	Total DAC per cent
Social infrastructure & services	**1 953**	**16**	**3 238**	**22**	**2 097**	**21**	**33**
Education	778	6	880	6	861	8	9
of which: basic education	-	-	91	1	91	1	2
Health	205	2	383	3	303	3	4
of which: basic health	-	-	142	1	94	1	3
Population programmes	9	0	26	0	14	0	3
Water supply & sanitation	490	4	1 666	11	501	5	5
Government & civil society	117	1	99	1	218	2	7
Other social infrastructure & services	355	3	185	1	200	2	6
Economic infrastructure & services	**4 653**	**39**	**6 648**	**45**	**3 734**	**37**	**15**
Transport & storage	1 970	16	3 573	24	2 460	24	9
Communications	577	5	346	2	69	1	1
Energy	1 551	13	2 573	17	1 146	11	4
Banking & financial services	495	4	60	0	38	0	1
Business & other services	60	0	97	1	21	0	1
Production sectors	**2 236**	**19**	**2 581**	**18**	**1 381**	**14**	**9**
Agriculture, forestry & fishing	1 414	12	2 012	14	1 164	11	7
Industry, mining & construction	787	7	536	4	194	2	1
Trade & tourism	35	0	33	0	22	0	1
Other	-	-	-	-	0	0	0
Multisector	**127**	**1**	**643**	**4**	**553**	**5**	**7**
Commodity and programme aid	**1 986**	**16**	**178**	**1**	**43**	**0**	**7**
Action relating to debt	**538**	**4**	**668**	**5**	**1 291**	**13**	**10**
Emergency assistance	**111**	**1**	**72**	**0**	**84**	**1**	**7**
Administrative costs of donors	**411**	**3**	**693**	**5**	**709**	**7**	**7**
Core support to NGOs	**24**	**0**	**17**	**0**	**268**	**3**	**4**
Total bilateral allocable	**12 038**	**100**	**14 738**	**100**	**10 159**	**100**	**100**
For reference:							
Total bilateral	*12 413*	*82*	*15 550*	*90*	*10 476*	*84*	*70*
of which: Unallocated	*375*	*2*	*812*	*5*	*316*	*3*	*3*
Total multilateral	*2 776*	*18*	*1 792*	*10*	*1 973*	*16*	*30*
Total ODA	***15 189***	***100***	***17 342***	***100***	***12 449***	***100***	***100***



Source: OECD

Table C-6 Comparative aid performance

Net disbursements

	Official development assistance			Grant element of ODA	Share of multilateral aid				ODA to LDCs Bilateral and through multilateral agencies		Official aid	
	2001		95-96 to 00-01 Ave. annual % change in real terms	(commitments) 2001	2001				2001		2001	
					% of ODA		% of GNI					
	USD million	% of GNI		% (a)	(b)	(c)	(b)	(c)	% of ODA	% of GNI	USD million	% of GNI
Australia	873	0.25	0.6	100.0	24.3		0.06		20.1	0.05	5	0.00
Austria	533	0.29	0.2	90.8	35.9	18.4	0.10	0.05	19.9	0.06	212	0.11
Belgium	867	0.37	3.5	99.6	42.1	20.1	0.15	0.07	34.0	0.13	88	0.04
Canada	1 533	0.22	-2.7	100.0	21.7		0.05		15.1	0.03	152	0.02
Denmark	1 634	1.03	4.8	100.0	36.7	31.3	0.38	0.32	33.0	0.34	181	0.11
Finland	389	0.32	4.8	100.0	42.3	28.1	0.14	0.09	29.4	0.09	61	0.05
France	4 198	0.32	-6.5	95.5	38.2	13.3	0.12	0.04	25.8	0.08	1 334	0.10
Germany	4 990	0.27	-1.2	95.8	42.8	19.8	0.12	0.05	23.5	0.06	687	0.04
Greece	202	0.17	8.2	..	59.1	12.5	0.10	0.02	10.9	0.02	9	0.01
Ireland	287	0.33	11.8	100.0	35.7	14.3	0.12	0.05	49.9	0.16	23	0.03
Italy	1 627	0.15	-2.3	99.6	72.8	34.8	0.11	0.05	29.9	0.04	281	0.03
Japan	9 847	0.23	3.0	88.2	24.3		0.06		18.1	0.04	84	0.00
Luxembourg	141	0.82	18.1	100.0	24.8	13.5	0.20	0.11	32.4	0.27	9	0.05
Netherlands	3 172	0.82	4.9	100.0	29.9	23.8	0.25	0.20	31.4	0.26	214	0.06
New Zealand	112	0.25	5.5	100.0	24.1		0.06		25.7	0.07	0	0.00
Norway	1 346	0.80	1.8	100.0	30.1		0.24		33.3	0.27	32	0.02
Portugal	268	0.25	6.7	94.7	31.7	6.0	0.08	0.02	44.5	0.11	28	0.03
Spain	1 737	0.30	7.2	95.1	33.8	14.1	0.10	0.04	11.1	0.03	14	0.00
Sweden	1 666	0.77	4.5	99.8	27.7	20.9	0.21	0.16	27.5	0.21	119	0.05
Switzerland	908	0.34	3.0	100.0	29.0		0.10		28.2	0.10	63	0.02
United Kingdom	4 579	0.32	5.7	100.0	42.7	24.8	0.14	0.08	36.0	0.12	461	0.03
United States	11 429	0.11	3.2	99.7	27.5		0.03		14.6	0.02	1 542	0.02
Total DAC	52 337	0.22	1.8	96.4	33.1	23.6	0.07	0.05	23.0	0.05	5 597	0.02
Memo: Average country effort		0.40										

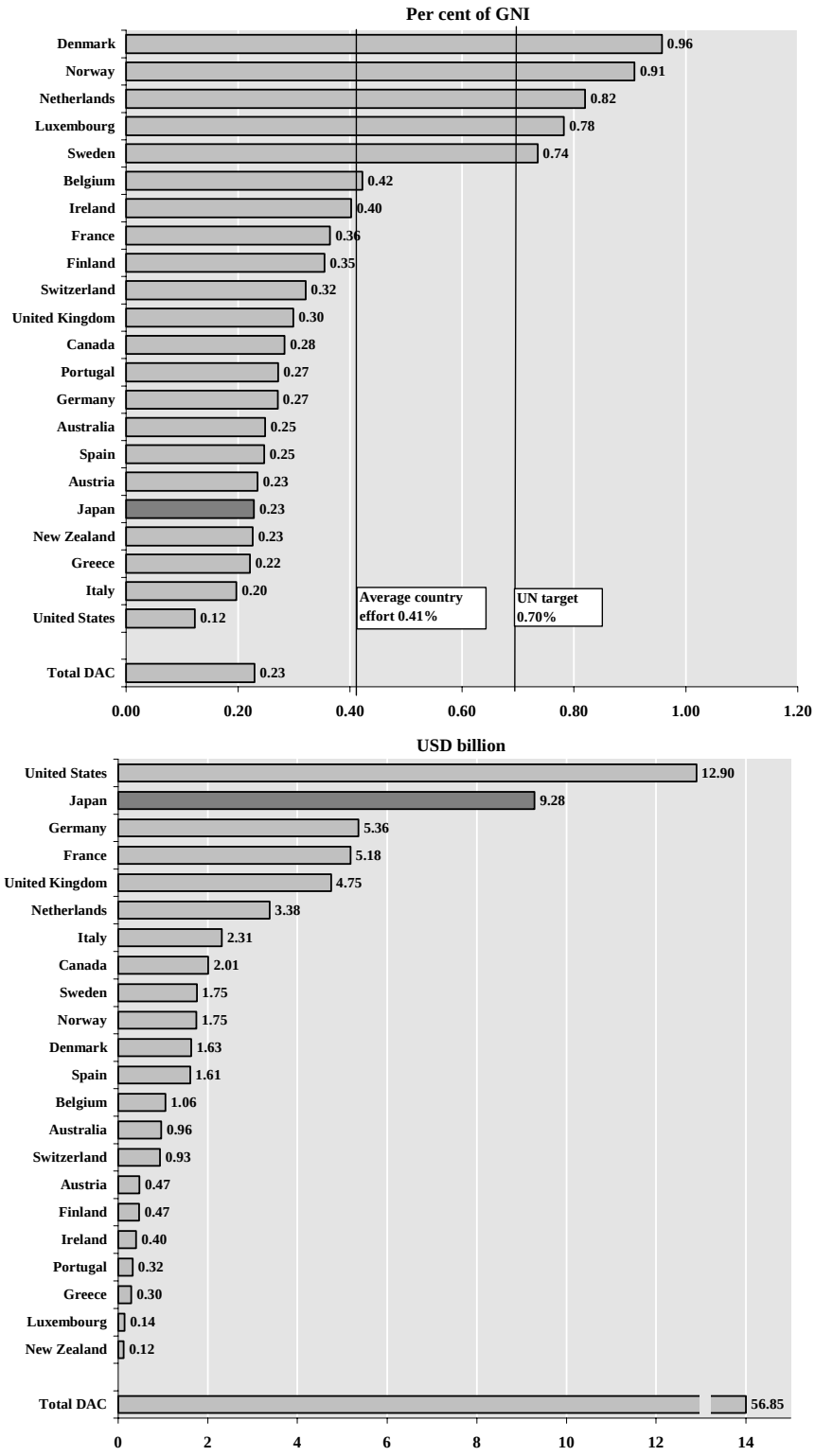
Notes:

a. Excluding debt reorganisation.
b. Including EC.
c. Excluding EC.
.. Data not available.

Source: OECD

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Figure C-1. Net ODA from DAC countries in 2002



Source: OECD

ANNEX D

CHARTS

Chart D.1. Ministry of Foreign Affairs (MOFA)

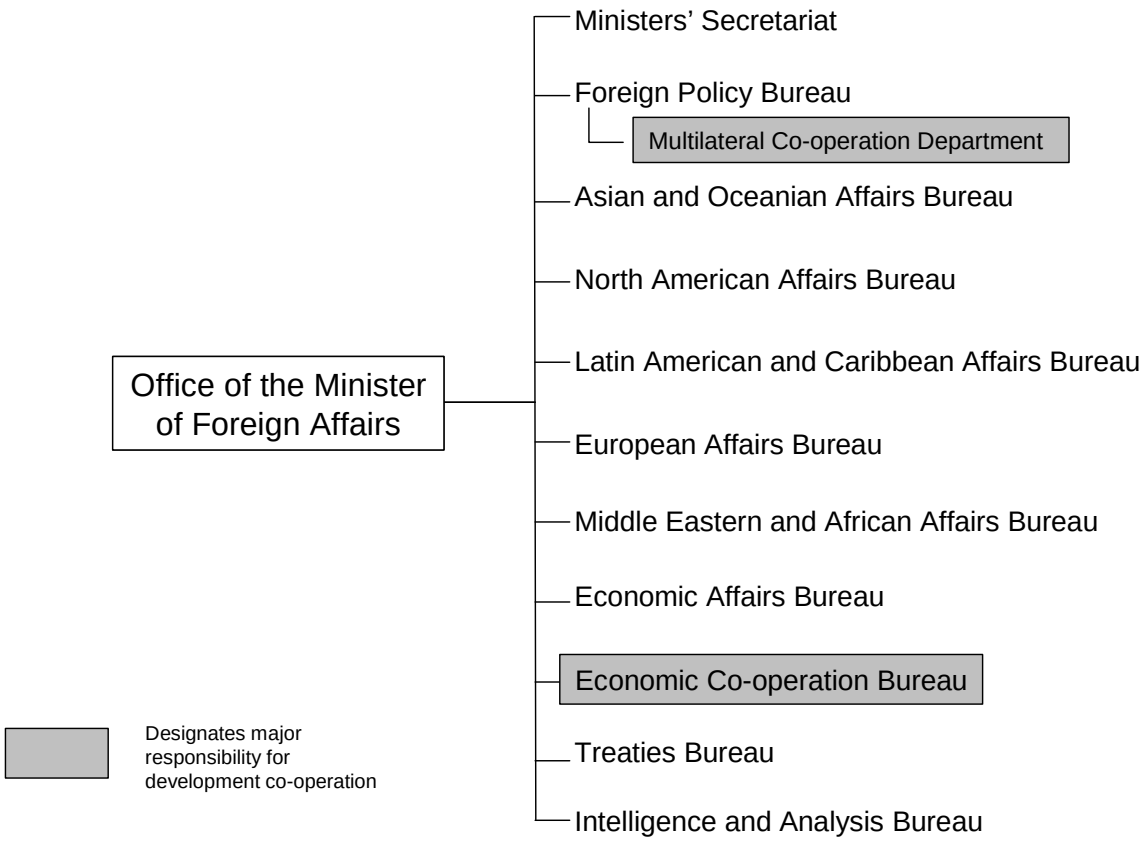
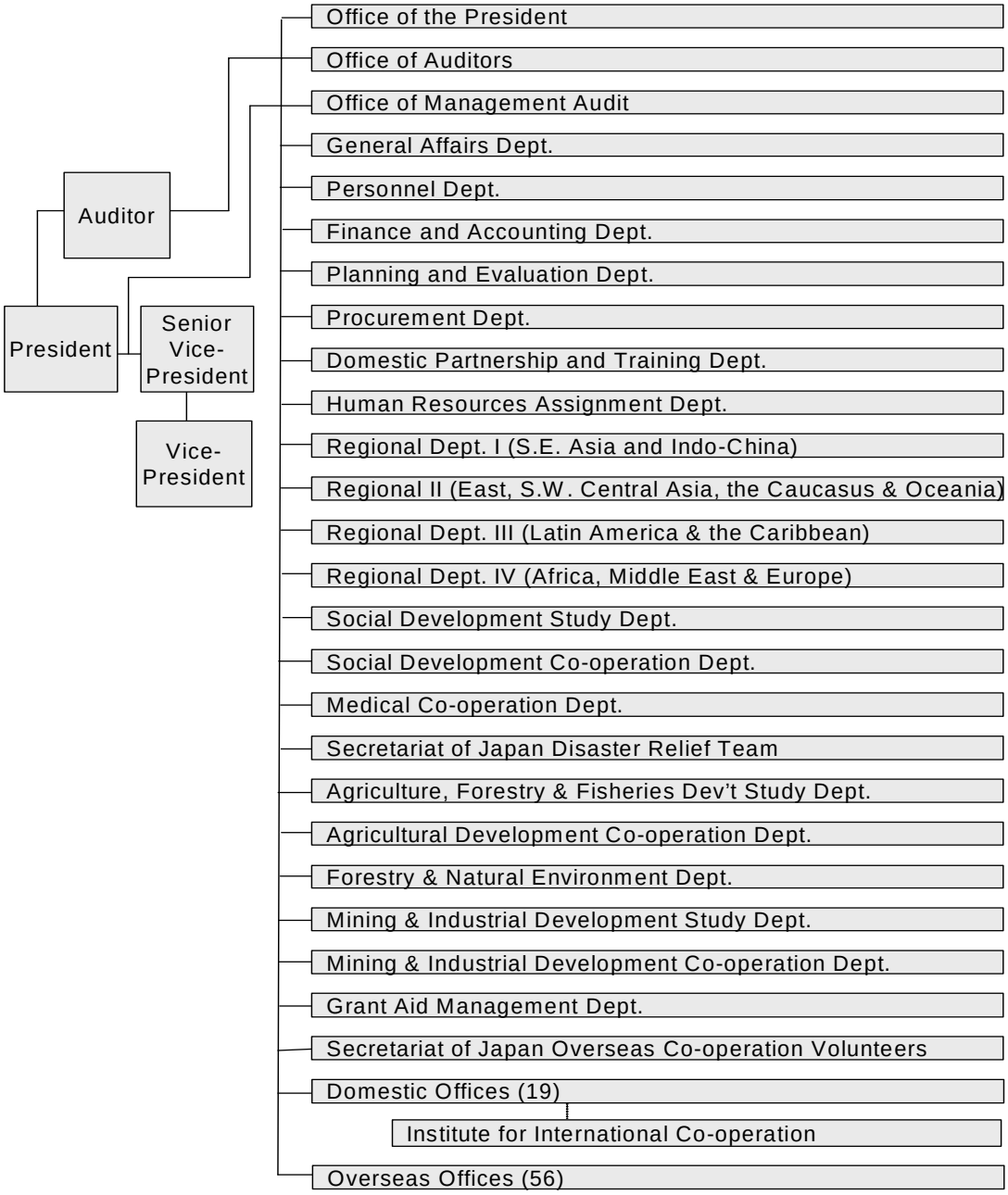
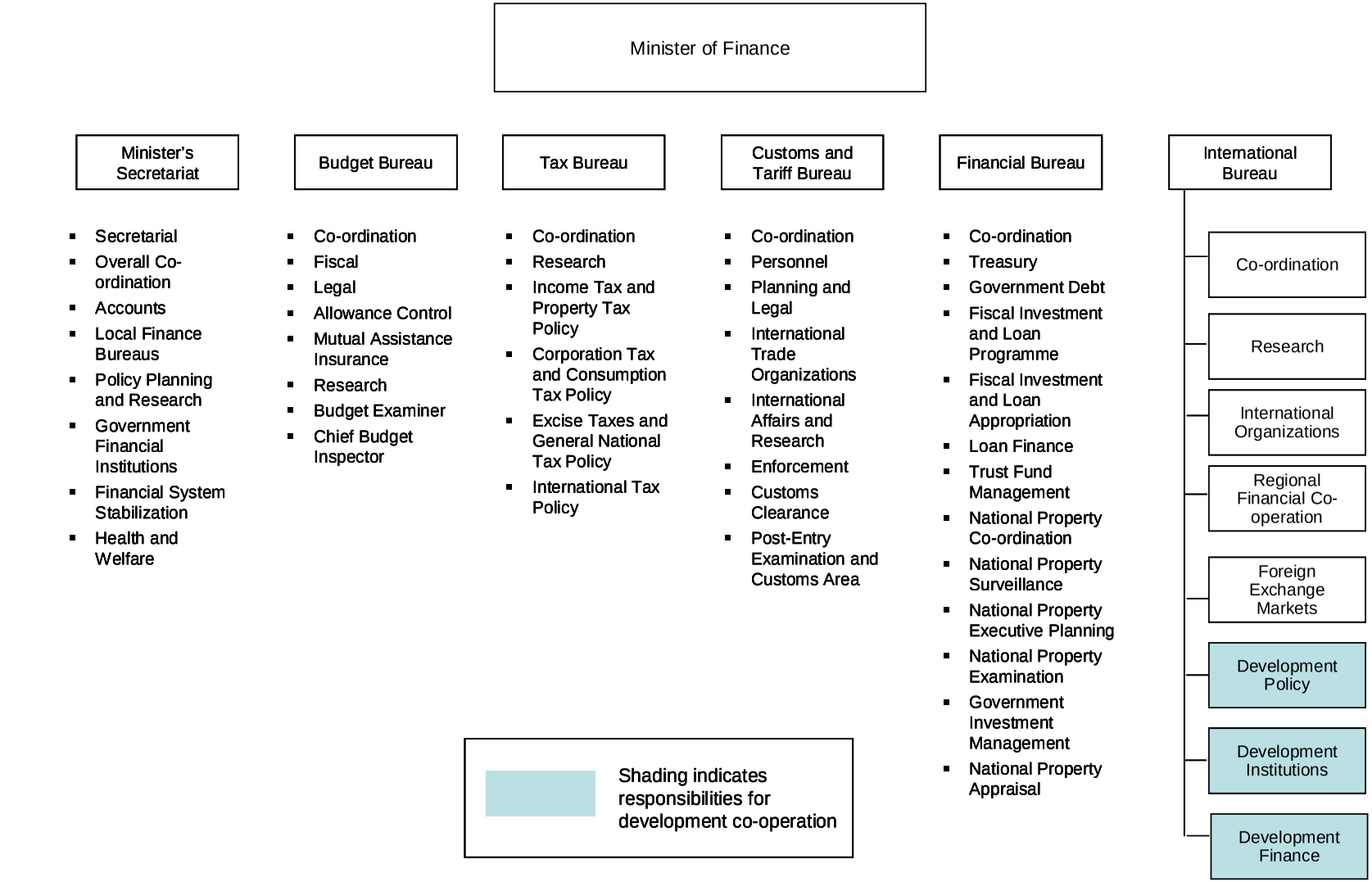


Chart D.2. JICA Organisation Chart



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Chart D.3. Ministry of Finance

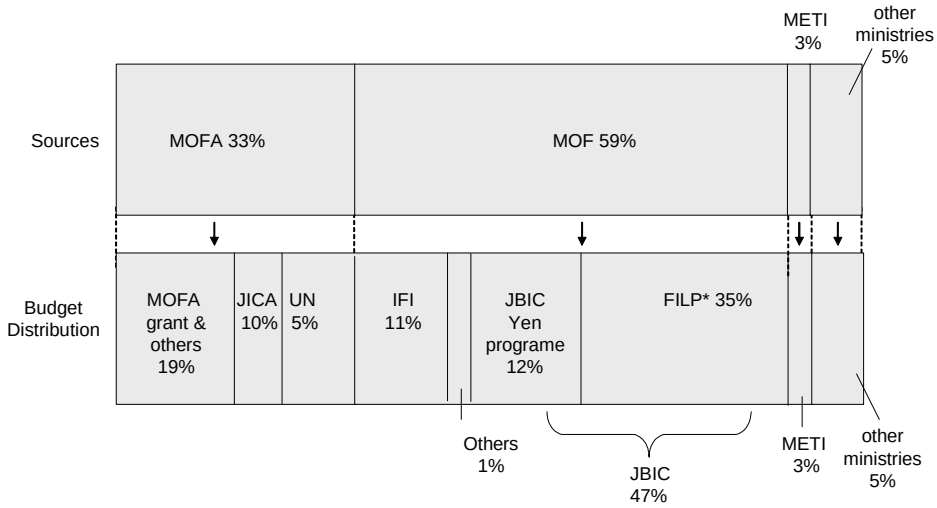


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ANNEX E

INSTITUTIONAL DISTRIBUTION OF ODA FUNDING

This chart was built upon **OECD estimates** of the institutional responsibility for Japanese ODA flows in 2002. It includes all official development assistance, whether from the national budget or elsewhere.



* The Fiscal Investment and Loan Programme (FILP), is a large, government-wide system to collect funds through government financial institutions (most notably postal savings) to finance public projects undertaken by government. JBIC also uses FILP to fund its ODA loan operations.

Source: OECD

The chart below has been supplied by the **Japanese authorities** to show the distribution of the General Account ODA budget.

Operational Budget Account

(MOFA)	MOF 59%			(FILP 35%)	(Other)
	IFI 12%	*	JBIC Yen Loan 46%		

*MOF & Others 1%

General Account

MOFA 59%			MOF 29%			METI 4%	Other Ministries
MOFA Grant & Others 33%	JICA 19%	UN 7%	IFI 5%	**	JBIC 24%		8%

**Others 0.2%

PRESS RELEASE OF THE DAC CHAIR'S REVIEW OF JAPAN

JAPAN STRIVES TO ALIGN POLICIES AND RESOURCES WITH NEW AID VISION

Japan's net official development assistance (ODA) was USD 9.3 billion in 2002, making it the world's second largest donor. Japan was the largest aid donor for almost a decade, from 1992 to 2001, until economic pressures led the government to reduce the size of its ODA. The 2002 level represented 0.23% of Japan's Gross National Income, down from 0.31% in 1991-2. At the Monterrey conference, Japan was one of the few aid donors unable to commit to increase its level of aid.

The OECD Development Assistance Committee (DAC) Peer Review of Japanese development co-operation noted positive reforms in Japan's aid strategy and management. Most importantly, Japan revised its ODA Charter, incorporating new strategic priorities more in tune with current international and domestic realities, including poverty reduction, sustainable growth, the need to address global issues and peace building. It also made changes to the two leading agencies that implement its aid: the legal status of the Japan International Cooperation Agency (JICA) changed in 2003 to make this technical co-operation agency more autonomous and efficient and, in 1999, two former loan agencies were merged into the Japan Bank for International Cooperation (JBIC). Finally, the Ministry of Foreign Affairs is now legally mandated to co-ordinate the diverse and often compartmentalised implementing institutions of ODA.

The review centered on the implications which implementing the new ODA Charter will have on Japan's aid system at headquarters and in the field. Specifically, the discussion addressed questions relating to fuller integration of crosscutting themes like poverty reduction into Japan's development strategy. It strongly encouraged Japan to increase its overall aid volume. It noted Japan's efforts to respond to crises. It urged the government to strengthen public support for sustained ODA and for achieving the Millennium Development Goals. The Committee encouraged Japan to consider raising the share of grant assistance in its ODA for low income, highly indebted countries. Other key topics included the need to improve policy coherence for development across ministries including the issue of agriculture. It also noted the utility of further streamlining and decentralizing Japan's aid management along the lines of promising approaches now being tested in Tanzania and Vietnam, which will require more and higher level staff. In this regard the Committee recognized Japan's support for co-ordination and harmonisation of donor practices in developing partner countries.

The review welcomed the stronger Japanese role in shaping the international consensus on development and the increasing convergence of views on economic growth and poverty reduction.

The DAC Peer Review of Japan's development co-operation policies and programmes took place on 12 December 2003. The meeting was led by the DAC Chair Richard Manning and the Japanese Delegation was headed by Motohide Yoshikawa, Deputy Director General, Economic Co-operation Bureau, Ministry of Foreign Affairs. The examiners for this Peer Review were the United States and the European Commission.

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DESCRIPTION OF KEY TERMS

The following brief descriptions of the main development co-operation terms used in this publication are provided for general background information.

ASSOCIATED FINANCING: The combination of official development assistance, whether grants or loans, with other official or private funding to form finance packages.

AVERAGE COUNTRY EFFORT: The unweighted average ODA/GNI ratio of DAC members, i.e. the average of the ratios themselves, not the ratio of total ODA to total GNI (cf. ODA/GNI ratio).

DAC (DEVELOPMENT ASSISTANCE COMMITTEE): The committee of the OECD which deals with development co-operation matters. A description of its aims and a list of its members are given at the front of this volume.

DAC LIST OF AID RECIPIENTS: The DAC uses a two-part List of Aid Recipients which it revises from time to time. Part I of the List comprises developing countries (eligible to receive official development assistance). It is presented in the following categories (the word "countries" includes territories):

LDCs: Least Developed Countries. Group established by the United Nations. To be classified as an LDC, countries must fall below thresholds established for income, economic diversification and social development. The DAC List is updated immediately to reflect any change in the LDC group.

Other LICs: Other Low-Income Countries. Includes all non-LDC countries with per capita GNP less than USD 760 in 1998 (World Bank Atlas basis).

LMICs: Lower Middle-Income Countries, *i.e.* with GNP per capita (Atlas basis) between USD 761 and USD 3 030 in 1998. LDCs which are also LMICs are only shown as LDCs – not as LMICs.

UMICs: Upper Middle-Income Countries, *i.e.* with GNP per capita (Atlas basis) between USD 3 031 and USD 9 360 in 1998.

HICs: High-Income Countries, *i.e.* with GNP per capita (Atlas basis) more than USD 9 360 in 1998.

Part II of the List comprises "Countries in Transition"; assistance to these countries is counted separately as “official aid”. These comprise (i) more advanced Central and Eastern European Countries and New Independent States of the former Soviet Union; and (ii) more advanced developing countries.

DEBT REORGANISATION (OR RESTRUCTURING): Any action officially agreed between creditor and debtor that alters the terms previously established for repayment. This may include forgiveness, rescheduling or refinancing.

DIRECT INVESTMENT: Investment made to acquire or add to a lasting interest in an enterprise in a country on the DAC List of Aid Recipients. In practice it is recorded as the change in the net worth of a subsidiary in a recipient country to the parent company, as shown in the books of the latter.

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DISBURSEMENT: The release of funds to, or the purchase of goods or services for a recipient; by extension, the amount thus spent. Disbursements may be recorded **gross** (the total amount disbursed over a given accounting period) or **net** (less any repayments of loan principal or recoveries of grants received during the same period).

EXPORT CREDITS: Loans for the purpose of trade and which are not represented by a negotiable financial instrument. They may be extended by the official or the private sector. If extended by the private sector, they may be supported by official guarantees.

GRANTS: Transfers made in cash, goods or services for which no repayment is required.

GRANT ELEMENT: Reflects the financial terms of a commitment: interest rate, maturity and grace period (interval to the first repayment of capital). The grant element is calculated against a fixed interest rate of 10%. Thus the grant element is nil for a loan carrying an interest rate of 10%; it is 100% for a grant; and it lies between these two limits for a loan at less than 10% interest.

LOANS: Transfers for which repayment is required. Data on net loan flows include deductions for repayments of principal (but not payment of interest) on earlier loans.

OFFICIAL AID (OA): Flows which meet the conditions of eligibility for inclusion in official development assistance, except that the recipients are on Part II of the DAC List of Aid Recipients.

OFFICIAL DEVELOPMENT ASSISTANCE (ODA): Grants or loans to countries and territories on Part I of the DAC List of Aid Recipients (developing countries) provided by the official sector with the promotion of economic development and welfare as the main objective and which are at concessional financial terms (if a loan, having a grant element of at least 25%).

ODA/GNI RATIO: To compare members'ODA efforts, it is useful to show them as a share of gross national income (GNI). "Total DAC" ODA/GNI is the sum of members'ODA divided by the sum of the GNI, i.e. the weighted ODA/GNI ratio of DAC members (cf. Average country effort).

OTHER OFFICIAL FLOWS (OOF): Developmentally relevant transactions by the official sector with countries on the DAC List of Aid Recipients which do not meet the conditions for eligibility as official development assistance or official aid.

TECHNICAL CO-OPERATION: Includes both (i) grants to nationals of aid recipient countries receiving education or training at home or abroad, and (ii) payments to consultants, advisers and similar personnel as well as teachers and administrators serving in recipient countries.

TIED AID: Official grants or loans where procurement of the goods or services involved is limited to the donor country or to a group of countries which does not include substantially all aid recipient countries.

VOLUME (real terms): Unless otherwise stated, data are expressed in current United States dollars. Data in national currencies are converted into dollars using annual average exchange rates. To give a truer idea of the volume of flows over time, some data are presented in constant prices and exchange rates, with a reference year specified. These data show the value of aid in terms of the domestic purchasing power of a US dollar in the year specified.

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Part IV

DAC Peer Review of France

26 May 2004

Abstract. This review contains the Main Findings and Recommendations of the Development Assistance Committee and the report of the Secretariat. It was prepared with examiners from Canada and the Netherlands for the review meeting on 26 May 2004. The principal issues covered were: draw up a policy document setting out the strategic directions for the entire co-operation system, based on the achievement of the MDGs, make policy coherence for development an explicit goal of the French government, seize the opportunity afforded by the reform of the Institutional Act on Finance Legislation to introduce a transparent and multi-year budgetary process as well as results-based management, review the geographical selectiveness, adjust aid planning to respond more closely to the needs expressed by partner countries, undertake a more in-depth analysis of the effectiveness of various instruments of French aid and take on a more active role in the implementation of aid effectiveness principles in partner countries. This report is published on the authority of the Secretary-General of the OECD.

Acknowledgements: This paper has been prepared by Marjolaine Nicod et Elisabeth Thioléron of the Development Co-operation Directorate's Review and Evaluation Division, with the assistance of Juana Aristizabal, Madeleine Paris, and DCD'Statistics and Monitoring Division. Any comments or queries should be addressed to <dac.contact@oecd.org>.

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The Peer Review Process

The DAC conducts periodic reviews of the individual development co-operation efforts of DAC members. The policies and efforts of each member are critically examined approximately once every four years. Five or six programmes are examined annually. The OECD's Development Co-operation Directorate (DCD) provides analytical support and is responsible for developing and maintaining the conceptual framework within which the Peer Reviews are undertaken.

The Peer Review is prepared by a team, consisting of representatives of the Secretariat working with officials from two DAC members who are designated as "examiners". The country under review provides a memorandum setting out the main developments in its policies and programmes. Then the Secretariat and the examiners visit the capital to interview officials, parliamentarians, as well as civil society and NGO representatives of the donor country to obtain a first-hand insight into current issues surrounding the development co-operation efforts of the member concerned. Field visits assess how members are implementing the major DAC policies, principles and concerns, and review operations in recipient countries, particularly with regard to poverty reduction, sustainability, gender equality and other aspects of participatory development, and local aid co-ordination. A recent innovation is to organise "joint assessments", in which the activities of several members are reviewed in a single field mission.

The Secretariat then prepares a draft report on the member's development co-operation which is the basis for the DAC review meeting at the OECD. At this meeting senior officials from the member under review respond to questions posed by DAC members led by the examiners. These questions are formulated by the Secretariat in association with the examiners. The main discussion points and operational policy recommendations emerging from the review meeting are set out in the Main Findings and Recommendations section of the report.

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LIST OF ABBREVIATIONS

ADETEF*	*Assistance au développement des échanges en technologies économiques et financières* (Assistance for the development of trade in economic and financial technologies)
AFD*	French Development Agency
C2D	Contracts for Debt Reduction and Development
CCFD*	*Comité catholique contre la faim et pour le développement* (Catholic committee against hunger and for development)
CICID*	Interministerial Committee for International Co-operation and Development
CIRAD*	*Centre de coopération internationale en recherche agronomique pour le développement* (French Agricultural Research Centre for International Development)
DAC	Development Assistance Committee
DCT*	Directorate for Development and Technical Co-operation
DGCID*	Directorate-General for International Co-operation and Development
DOM*	*Départements d'outre-mer* (Overseas departments)
DREE*	Directorate for External Economic Relations
DSP*	*Documents de stratégie-pays* (Country strategy papers)
EDF	European Development Fund
EU	European Union
FASEP*	Fund for Assistance to the Private Sector
FFEM*	French Global Environment Facility
FSD*	*Fonds social de développement* (Social development fund)
FSP*	Priority Solidarity Fund
GNI	Gross national income
GPGs	Global public goods
HCCI*	High Council for International Co-operation
HIPCs	Heavily-indebted poor countries
IFI	International financial institutions
LCPI*	*Lutte contre la pauvreté et les inégalités* (Measures to combat poverty and inequality)
LDCs	Least developed countries
LOLF*	Loi organique relative aux lois de finances (Institutional Act on Finance Legislation)
MDGs	Millennium Development Goals
MINEFI*	Ministry for Economic Affairs, Finance and Industry
MAE*	Ministry of Foreign Affairs
NEPAD	New Partnership for Africa's Development
NGO	Non-governmental organisation

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ODA	Official development assistance
OSI*	*Organisation de solidarité internationale* (International solidarity organisation)
PNDSE*	*Plan national de développement du secteur éducatif* (National plan for the development of the education sector)
POS*	*Projet d'orientation stratégique* (Strategic guidance project)
PRSPs	Poverty Reduction Strategy Papers
RECAMP*	Reinforcement of African peace-keeping capabilities
RPE*	Emerging economies fund
RPI	Reducing poverty and inequality
SCAC*	Co-operation and cultural action service
TA	Technical assistance
TOM*	Overseas Territories
UNDP	United Nations Development Programme
UNIFEM	United Nations Development Fund for Women
WTO	World Trade Organization
ZSP*	Priority zone for solidarity

* Denotes acronym in original language

Signs used:

EUR	Euro
USD	US dollar

( )	Secretariat estimate in whole or in part
-	Nil
0.0	Negligible
..	Not available
…	Not available separately but included in total
n.a.	Not applicable

Slight discrepancies in totals are due to rounding

Exchange rates (EUR per US dollar)

2000	**2001**	**2002**
1.0851	1.1166	1.0611

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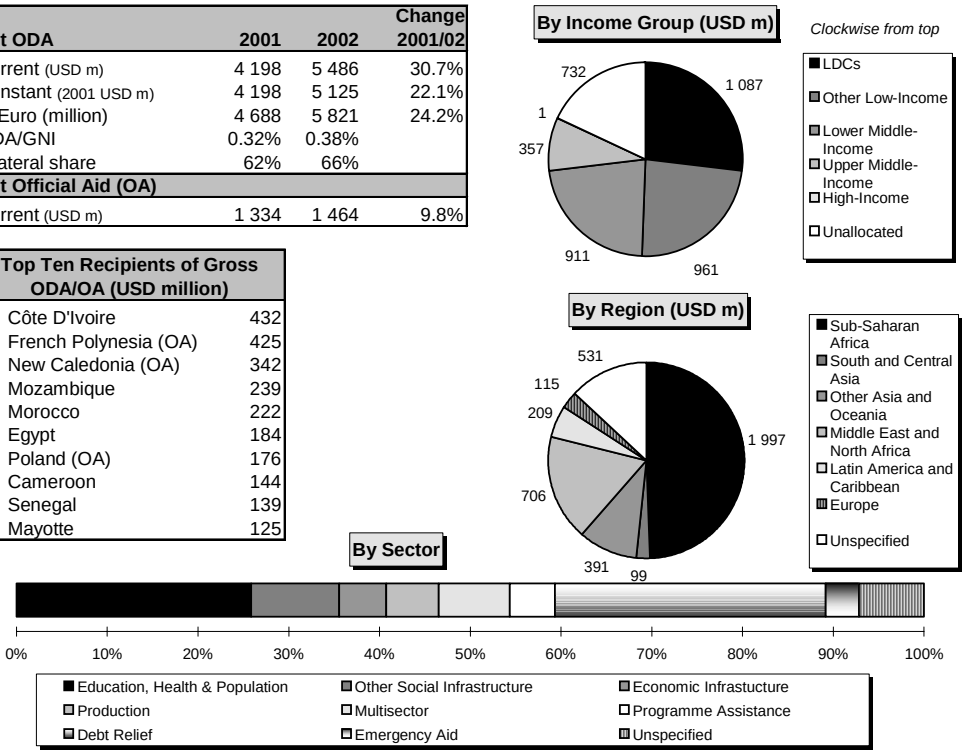
France's Aid at a glance

FRANCE

Gross Bilateral ODA, 2001-02 average, unless otherwise shown

Net ODA	2001	2002	Change 2001/02
Current (USD m)	4 198	5 486	30.7%
Constant (2001 USD m)	4 198	5 125	22.1%
In Euro (million)	4 688	5 821	24.2%
ODA/GNI	0.32%	0.38%	
Bilateral share	62%	66%	
Net Official Aid (OA)			
Current (USD m)	1 334	1 464	9.8%

Top Ten Recipients of Gross ODA/OA (USD million)	
1 Côte D'Ivoire	432
2 French Polynesia (OA)	425
3 New Caledonia (OA)	342
4 Mozambique	239
5 Morocco	222
6 Egypt	184
7 Poland (OA)	176
8 Cameroon	144
9 Senegal	139
10 Mayotte	125



Source: OECD

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DAC'S MAIN FINDINGS AND RECOMMENDATIONS

General framework and new directions

A renewed commitment to development

2002 marked a turning point in French development co-operation policy, an area that the President of the Republic has made one of his priorities. At the International Conference on Financing for Development held in Monterrey in 2002, the French President pledged to increase France's official development assistance (ODA) to 0.5% of gross national income (GNI) by 2007 and ultimately to 0.7% by 2012. At least half of this aid would be directed towards Africa to help achieve the Millennium Development Goals (MDGs) and to support the areas specified in the New Partnership for Africa's Development (NEPAD).

France is keen to promote the mobilisation of development funding: it has endorsed the United Kingdom's proposal to set up an International Finance Facility and joined in other initiatives aimed at promoting public/private partnerships. France has also commissioned a working party to draw up proposals regarding international taxation. In addition, France is supporting more effective forms of aid, as may be seen from its international commitment to the harmonisation of donor practices and procedures.

Plurality of goals: an impediment to a unified vision of French policy

The plurality of goals which French co-operation must meet is partly due to the complexity of its system. The Ministry of Foreign Affairs (MAE) and the Ministry of Economic Affairs, Finance and Industry (MINEFI) have joint responsibility for the strategic management of ODA. The French Development Agency (AFD) acts as principal operator.

Each of these structures has its own culture and a mandate in which development is not the sole objective. The MAE, with responsibility for co-operation and cultural actions, combines solidarity with influence in support of French diplomacy. The MINEFI is responsible for macroeconomic and financial aid and therefore for debt management, monetary and financial co-operation with CFA franc zone countries, promoting investment, export financing, and economic and financial relations with developing and transition countries as well as with international financial institutions. The mandate of the AFD, whose sphere of action includes both developing countries and France's overseas departments and territories, is to promote stable economic and financial development that will both maintain social cohesion and safeguard the environment.

Despite having several key principles – priority to Africa, global public goods and the regulation of globalisation, sustainable development, democratic governance, cultural diversity and La Francophonie – French development policy does not project a unified vision. An overview of the directions for ODA would therefore seem warranted in order to rank goals by order of importance, clarify geographical, sectoral and thematic choices, and determine the role of different institutions and

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instruments, notably with regard to the MDGs. A policy statement could provide a collective platform and serve as an instrument for communication at the national and international level. It would provide a starting point for involving civil society organisations in the design and implementation of policy and strategy, on the one hand, and in raising public awareness of MDGs on the other.

Efforts needed to focus action on achieving the MDGs

With France now embracing the MDGs, reducing poverty and inequality has become an explicit axis of co-operation, as shown by the depth and breadth of the discussions initiated by French institutions. Rather than targeting the poor, the French approach is aimed at integrating poor and marginalised populations into global interventions and at diversifying remedial strategies to meet the needs of the social groups concerned. This approach is starting to take account of gender, but this dimension has yet to be mainstreamed. The creation of a budget focused on gender promotion and the development of monitoring and evaluation tools to assess progress might be useful in this respect. As a general rule, French co-operation could make greater use of in-depth socio-economic analyses, including those of the relationship between gender and poverty.

The French approach leads to actions being dispersed among different levels (national, regional and local) and requires a wide range of actors and instruments whose coherence and co-ordination could be improved. While sectoral priorities have been identified (education, health and the fight against HIV/AIDS, water and sanitation, rural development, infrastructure and environment), they are not always linked to the goal of reducing poverty and inequality. French co-operation would benefit from a consolidated position on the fight against poverty and inequalities which would spell out precisely how France intends to make a practical contribution to meeting the MDGs. With regard to education, which accounts for almost a quarter of France's bilateral ODA, only a modest share of activities is aimed at improving educational systems in developing countries. France's support for the "Education for All" initiative is a positive action in this respect and should be stepped up.

Harmonisation: an objective that needs to be translated into action in the field

France plays a leading role at the international level in harmonising aid procedures and practices. France currently chairs the DAC Working Party on Aid Effectiveness and Donor Practices and in 2005 will host the follow-up to the high-level forum on aid effectiveness held in Rome in 2003. An action plan setting out how France intends to implement the principles of the Rome Declaration is currently being prepared. The implementation process is only just starting, however, and the efforts made in Paris have yet to make a substantial impact in the field. The adoption of a programme-based approach does not necessarily lighten the administrative burden that aid management imposes on partner countries, given that in Mauritania, for example, French support for the ten-year programme in the education sector is channelled through three different channels (budget support, administered by the AFD, and an institutional support project and technical assistance, both administered by the MAE).

Recommendations

- Draw up a policy document setting out the strategic directions for the entire co-operation system, based on the achievement of the MDGs and on the principle of aligning French co-operation with the strategies adopted by partner countries towards the fight against poverty.
- Take on a more active role in the implementation of aid effectiveness principles in partner countries; this will entail finalising and disseminating the action plan for harmonisation, specifying the objectives to be achieved as well as indicators of results and timetables.

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Aid volume and distribution

The challenges posed by growth in ODA

France is well on the way to fulfilling the commitment made at Monterrey. France's ODA increased significantly between 2001 and 2003, rising in volume terms from USD 4.2 billion to USD 7.3 billion and in terms of ODA/GNI from 0.32% to 0.41%. Consequently, France is the most generous G7 donor country. However, a large share of this growth is currently attributable to debt relief under the initiative for heavily indebted poor countries (HIPC), which in 2002 accounted for almost a quarter of all French ODA.

The gradual implementation of the HIPC initiative is a major challenge for France. In the near future, once most of the countries concerned have completed all stages of the debt relief process planned under the initiative, a substantial reduction in debt relief efforts is to be expected. It will then be necessary for the French government to step in to maintain the level of ODA and ensure that it continues to grow. Estimates indicate that ODA may rise to around USD 9 billion by 2007. Mobilising such additional funding in a difficult budgetary context is a major challenge for the government. The programming and procedures for implementing these resources, not to mention the implications in terms of human resources, are other issues that the French authorities will have to turn their full attention to without delay.

Insufficient selectiveness despite the priority given to Africa and to least developed countries

Given the scale of the debt relief programme, the increase in ODA has scarcely generated any flows of fresh money to developing countries for the time being. Moreover, this growth has not yet afforded room for manoeuvre to allow France, through appropriate budget decisions, to follow the strategic orientations announced. The challenges of achieving the MDGs in a large number of sub-Saharan African countries – which receive 62% of bilateral ODA – raise the question of aid effectiveness and should compel the French authorities to consider which countries should be given priority for ODA. An analysis should be made of the timeliness of setting priorities within the priority zone for solidarity (ZSP), which contains fifty or so countries. The criteria to take into account should concern the level of poverty and needs in terms of achieving the MDGs, the introduction of sound social and economic policies, good governance and respect for human rights.

Multilateral co-operation: a more explicit strategy needed

France's desire to play a more influential role within international bodies warrants a more explicit strategy at the multilateral level. Such a strategy could in particular specify the bodies to whose support the French authorities plan to give priority and serve as a basis for better synergies between multilateral and bilateral action. France tends to give priority to global funds such as the Global Fund to fight AIDS, Tuberculosis and Malaria, to which in 2003 France announced the tripling of its annual contribution. As is the case for other European Union (EU) Member states, European aid accounts for a substantial share of French ODA (64% of multilateral ODA and 19% of total ODA in 2002). Its contributions to the multilateral development banks represented 6% of its ODA in 2002. Contributions to United Nations institutions – to which France appears to attach strategic importance in response to the challenges of globalisation – are low (2% of total ODA in 2002) and lower than the DAC average (7%).

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Making ODA more transparent

It is difficult to link ODA with budgetary appropriation. This is the case for some debt relief operations, France's budgetary contribution to the development activities of the European Commission (other than the European Development Fund) and *ex post* accounting of certain expenditure in accordance with DAC definitions (costs induced in France by students from developing countries, costs of assisting refugees and administrative costs). In addition, there is no annual report on French ODA as a whole.

The implementation of the Institutional Act on Finance Legislation (LOLF) from 2006 onwards should make ODA far more transparent. The LOLF will provide for MAE and MINEFI activities to be combined into a single mission, consisting of two programmes, for funding appropriations: (i) economic and financial aid for development; and (ii) solidarity with developing countries. The creation of an interministerial mission for ODA offers a unique opportunity to consolidate the goals of French co-operation and planning process through budgetary reorganisation and the drafting of a cross-cutting policy document.

Recommendations

- Determine the planning principles and implementation procedures for the budget resources that will be mobilised to compensate for the gradual reduction in debt relief.
- Review geographical selectiveness within the ZSP by setting priorities according to the needs with regard to achieving MDGs and the potential impact in view of the commitment made by beneficiary countries.
- Explain multilateral strategy in greater detail, including budgetary choices, and incorporate the lessons learned from bilateral experience into multilateral actions.
- Seize the opportunity afforded by the LOLF to introduce a transparent and multi-year budgetary process, as well as results-based management, by using the cross-cutting policy document as a framework in which to translate strategic directions into budgetary choices.

Policy coherence for development

Promoting globalization with a human face, based on democratic principles and social equality, is one of France's central concerns. The President of the Republic has launched several initiatives aimed at integrating African countries into the global economy. The trade initiative for Africa led to the EU action plan to create fairer trading conditions in the international market for African cotton-producing countries. France could follow up on this example and use its influence to encourage the European Commission to pursue reforms in areas which would assist developing countries in sectors where they have a comparative advantage but which were not covered by the reform of common agricultural policy in 2003. French bilateral co-operation has often assisted the development of key sectors in the economy of partner countries and expansion of their export capacities, for example cotton in Sahel countries or fishing in Mauritania. French institutional support has also helped strengthen the negotiating capacities of these countries, allowing them to play a more active role at the international level.

The complexity of the issues at stake in terms of policy coherence requires systematic action at the political and administrative levels. EU Member states must intervene simultaneously at the national level and at that of the European Community. France's commitment in this respect has not been explicitly endorsed in the form of a political declaration in which policy coherence for

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development is identified as an objective for all government actions. The impetus in this area would seem to depend largely upon presidential initiatives. Interministerial co-ordination structures and analytical capacities do not appear to be sufficiently mobilised to ensure that greater account is taken of the interests of developing countries in decision-making processes. The creation of a co-ordinating unit, specifically tasked with ensuring policy coherence, at the level, for example, of the Interministerial Committee for International Co-operation and Development (CICID) might be helpful.

Recommendations

- Make policy coherence for development an explicit goal of the French government and specify the institutional arrangements to be used – in particular co-ordination mechanisms and arbitration procedures.
- To ensure that the interests of developing countries are taken into account more systematically in the policies pursued by France, initiate a more rigorous debate by identifying the practical objectives to be achieved at ministerial level and within the administration.

Aid management and implementation

Incomplete division of responsibilities between strategy and implementation

The 1998 reform of co-operation had been aimed at improving the effectiveness and co-ordination of the institutional system around two focal points for policy, the MAE and MINEFI, with the AFD as the principal operator. Interministerial co-ordination has been improved by the creation of the CICID which is tasked with specifying the objectives of ODA and the procedures for its implementation, ensuring the coherence of geographical and sectoral priorities, as well as monitoring and evaluating policies and instruments. This committee, whose secretariat is provided jointly by the MAE and MINEFI, has successfully managed to instigate a dynamic process of formal and informal co-ordination. Its power to generate strategic momentum deserves to be strengthened, however, which would require meetings at more frequent intervals and a stronger secretariat.

The dispersion of activities among several institutions is costly. It requires both co-ordination and clear definitions of the responsibilities of the actors concerned. It also leads to duplication of know-how at the headquarters of institutions and in the field. France's stated intention of entrusting the principal role in ODA implementation to the AFD has not been fully translated into action inasmuch as the latter is responsible for managing only about 10% of total ODA, with MAE and MINEFI responsible for 29% and 40% respectively. The division of responsibilities between the MAE and AFD should be clarified to make their complementarity a stimulus for synergy rather than competition. As part of its modernisation programme, the MAE looked into ways of enhancing its effectiveness, notably in terms of strategy. Following a strategic reorientation in 2002, the AFD plays a more active role in discussions relating to development in France and at the international level. Activities in the field also reveal overlaps between the actions pursued by the MAE and those by the AFD (particularly with regard to health and education). The question of the division of responsibilities between these two institutions will be even more pressing as greater use is made of the programme approach in French co-operation.

The MINEFI shares with the MAE the responsibility for strategic management of ODA. In this respect, compared with other DAC members, the MINEFI has prerogatives that go beyond the

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traditional role of a ministry of finance. The scope of this ministry's responsibilities with regard to ODA calls for an increase in staff with greater operational experience.

Review instruments and implementation procedures to ensure greater effectiveness

The reference to the MDGs shows that aid effectiveness and the impact of aid are crucial issues for France. This should prompt France to examine the comparative advantages of various instruments and procedures for co-operation according to the needs of partner countries. The DAC missions to Benin and Mauritania have revealed France's desire to integrate co-operation more closely into strategies to combat poverty drawn up by partner countries. Despite the adoption of country strategy papers (DSP), French co-operation is not part of a multi-year planning process in which not only would the goals targeted be specified, along with indicators of results, but also implementation procedures and the respective responsibilities of actors. French co-operation remains fragmented and divided into numerous sectors and projects, generating high transaction costs for both the French authorities and partner countries. This damages the transparency of France's action, including its contribution to the achievement of the MDGs.

France is keen to retain an important role for project aid. This form of assistance allows scope for experimentation and direct contact with realities in the field. Technical assistance (TA) is a key instrument which has evolved considerably since the early 1990s in that numbers have declined from 20 000 to 2 200. TA should henceforth be incorporated into projects aimed at building capacities. To ensure that nationals can subsequently take over from the aid advisors, it would be advisable to: identify requirements more precisely; make provision at the project design stage for the withdrawal of TA; and systematically assess its impact in terms of capacity building. Greater use should be made of the scope for pooling TA funding resources between donors, particularly with regard to the implementation of national poverty reduction strategies and programme approaches.

Shifting to a programme approach

A new instrument, the C2D (debt relief and development contract), provides the means for France to test the implementation of the programme approach. This instrument consists in refinancing ODA debt repayments from HIPCs through grants. The resources thereby released are allocated in the form of budgetary support for certain priority activities (basic education and vocational training, primary health care and the fight against major endemic diseases; infrastructure and facilities for local communities and territorial development; natural resource management). Use of C2Ds has allowed France to support national sectoral strategies in a few countries, in collaboration with other donors, but this approach is based on a complex management system and has high transaction costs. In some countries, France assists the transition to budget support by providing technical assistance for the preparation and implementation of the state budget, in close co-ordination with international financial institutions.

The deeper dialogue and closer co-ordination with partners within the framework of national poverty reduction strategies and the programme approach call for a different set of skills to that required for project implementation. The efforts needed to implement new approaches towards harmonisation and the alignment of practices and procedures must not be underestimated either. The French authorities have started to reflect upon the implications of this development with regard to the mix of skills required and the degree of authority to be delegated to representatives in the field. The complexity of the French system argues in favour of increasing the resources in the field devoted to analysis, collaboration, co-ordination and training.

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Towards greater participation by civil society organisations

The dialogue with civil society has intensified, as has co-ordination with non-governmental actors. The High Council for International Co-operation (HCCI) has enabled the creation of a forum where the various actors involved in co-operation, non-governmental organisations (NGOs) and territorial authorities can meet and hold discussions. The government has on several occasions reasserted its desire to promote more wide-ranging participation by actors from French civil society and territorial authorities. A broader dialogue should be initiated with these actors regarding their role in strengthening civil society in developing countries and the implementation of national poverty reduction strategies. In this context, French authorities may need to strengthen co-ordination in the field and consider the current level of NGO co-financing, which is one of the lowest among DAC members.

Measuring performance and knowledge management: A culture that is moving forward

Evaluation has evolved in terms of methodology in that the scope of evaluation has been broadened to include approaches by country, sector and instrument, and measures have been taken to improve feedback. Progress still needs to be made in terms of disseminating evaluation reports, which are not always published, capitalising on lessons learned and analysing impacts. A number of initiatives are currently in progress to introduce results-based management into the implementation of the LOLF at the MAE and MINEFI and into the new strategic directions of the AFD.

The compartmentalisation of actors and instruments results in the dispersion of information and limits the benefits derived from implementation experience. The creation of interministerial working parties and the networking of intellectual and operational resources are practices that should eventually bear fruit, provided that the discussions within these parties are reflected at the level of strategy.

Recommendations

- Adjust aid planning to respond more closely to the needs expressed by partner countries through their national poverty reduction strategies, rather than in terms of the instruments used by French co-operation, and introduce budgetary programming by country in order to enhance aid predictability.
- Assess the advantages and disadvantages of keeping various implementation structures in place, both at headquarters and in partner countries. On the basis of the experience gained with C2Ds, undertake a more in-depth analysis of the effectiveness of various instruments of French aid in relation to the shift towards the programme approach and budget support.
- Pursue efforts to adjust technical assistance to strengthen its contribution to capacity building, while assessing its opportunity cost compared with other instruments. Consider untying such assistance, co-financing with other donors and increased use of local or regional expertise.
- Encourage initiatives aimed at interinstitutional capitalisation on know-how and experience, including evaluation.

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SECRETARIAT REPORT

CHAPTER 1

GENERAL STRATEGIC FRAMEWORK AND NEW DIRECTIONS

The context

The reform of French co-operation

The DAC's last peer review of France, in 2000, introduced the reform of the development assistance system that had been approved by the Council of Ministers in 1998. The reform had four objectives:

- Make aid more selective and concentrated on a priority zone for solidarity, the ZSP, made up of poor countries without access to international financial markets.
- Create a more efficient institutional system, better co-ordinated around clear targets, with the object of enhancing the co-ordination of public actors and making for more coherent implementation of the instruments of co-operation.
- Establish a better linkage between French bilateral co-operation and that of the multilateral institutions, including the European Union.
- Increase coherence between public action and that of non-governmental actors.

Set up in 1998, the CICID was given the task of carrying out the reform (see Box 1) and piloting ODA. Accordingly, it establishes the objectives and procedures of ODA, sees to it that the geographical and sectoral priorities are coherent and ensures the monitoring and evaluation of aid policies and instruments.

The reform triggered a process of change in the French system, as is shown by the modernisation now in progress in the MAE and the recent repositioning of the AFD (see Chapter 5). In the context of the implementation, by 2006, of the Institutional Act on Finance Legislation (LOLF), the creation of an interministerial mission on ODA provides a unique opportunity to consolidate the objectives of French co-operation by radically changing the budget nomenclature and preparing a cross-cutting policy document (see Chapter 2). Such positive steps should not conceal the fact that some of the issues raised during the last DAC review are still unresolved (see Annex A).

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Box 1. The reform has in principle been completed, but much remains to be done

While the innovations introduced by the reform have brought a number of improvements they have also attracted some criticism, which would suggest that the reform could be taken further in certain areas (Senate, 2001 and HCCI, 2002):

- The large number of ZSP countries, some of which have access to capital markets, shows that selectiveness does not yet appear to have been achieved. Geographical dispersion is resulting in the action and resources made available to each country being spread too thinly.
- Interministerial co-operation has been enhanced by the creation of the CICID, chaired by the prime minister, but it would be further improved if the committee met more often. The capacity of the CICID to drive strategic choices as regards development assistance needs to be strengthened because, "being compromise-oriented, it tends not to establish clear priorities and has difficulty in shifting direction on the basis of clear-cut policy options" (Commissariat général du Plan, 2002).
- The institutional framework of French aid changed substantially with the merging of the MAE and Secretariat of State for Co-operation and *Francophonie*. Within the MAE, the change resulted in the creation of the Directorate-General for International Co-operation and Development (DGCID) which, because of the sheer range of its responsibilities, is a fairly cumbersome institutional mechanism. Opinions differ as to the outcome of having merged the diplomatic and co-operation-oriented approaches and their respective administrative cultures. Bringing the two together has been mutually rewarding, but there have been only limited exchanges of experience and career prospects vary widely depending on officials' backgrounds. In addition, the merger appears to have had little impact on the critical influence of the Treasury Directorate on the decisive aspects of French co-operation policy (Senate, 2001).
- Country strategy papers (DSPs) were designed to serve as both a diagnosis and a reference framework for co-operation as a whole in each country. DSPs are for the most part not available to the public; their preparation is confidential and their linkage with the Poverty Reduction Strategy Papers (PRSPs) does not always seem very certain.
- The emphasis on evaluation is one of the most positive aspects of the reform, but the proposal that the CICID should discuss a report assessing French co-operation every year has not been followed up. That said, a working party chaired by an auditor-general has helped to tighten up the methodological side of the evaluation exercise.
- Both the DGCID and the AFD run schemes in partnership with bilateral and multilateral organisations, including the EU. Even so, France's influence within these institutions is not totally apparent. The political capital at its disposal in multilateral and European institutions could be better used, as was the case with the handling of debt. Its contributions and role within the United Nations family are also seen as insufficient.
- The relations between the public authorities and the representatives of French civil society have improved with the creation of the HCCI. The composition of the latter has been changed and its responsibilities redefined to encompass local authorities and ensure that parliament and elected representatives are more involved in its work. Other movements have come into being spontaneously and have added weight to the dialogue. The lessons born of the experience of the International Solidarity Organisations (OSIs) are not, however, really being put to good use by the public authorities.

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The proposals made by the President of the Republic: a turning point in French policy

At major international meetings over the past two years, the President of the Republic has never missed an opportunity to plead for increased development assistance, for far-reaching changes in methods of production and consumption, for globalisation 'with a human face' and 'for the benefit of all', and for cultural diversity. At the International Conference on Financing for Development, held in Monterrey in 2002, France announced that it was increasing its ODA over the coming five years with the object of reaching 0.5% of GNI by 2007 and 0.7% by 2012. This announcement confirmed its commitment to achieving the MDGs adopted at the Millennium Summit in 2000. At least 50% of France's aid is expected to go to Africa, being concentrated in areas identified by the NEPAD. In addition to seeking to mobilise resources in support of development, France is militating for more efficient use of these resources, as is evidenced by its commitment at the Rome High-Level Forum on Harmonisation in 2003 and by offering to host the follow-up meeting in Paris in 2005.

At the World Summit on Sustainable Development in Johannesburg in 2002, the President of the Republic joined with the British Government in supporting an initiative aimed at raising private funds in favour of poor countries. The Franco-British effort should generate EUR 1 billion of new investment to help fund the implementation of large-scale infrastructure projects, with each country mobilising EUR 100 million over three years. France also supports the International Finance Facility, which is intended to mobilise additional resources to help meet the MDGs, and in 2004 organised a conference on new ways of financing development.

Chaired by France, the 2003 G8 Summit in Evian extended the dialogue to a dozen emerging and developing countries in Asia, Africa and Latin America. At the same time, the President of the Republic confirmed France's commitment in support of the G8 Africa Action Plan, adopted the previous year in Kananaskis (MAE/DGCID, MINEFI/Direction du Trésor and AFD, 2003) and launched a plan to make Africa more involved in world trade (see Chapter 4). Also in Evian, the President of the Republic announced the doubling of ODA for water and said that the G8 countries had adopted an action plan aimed at reviving investment in that sector.

The President of the Republic has spoken publicly in favour of the campaign against AIDS. At the International Meeting to Support the Global Fund to Fight AIDS, Tuberculosis and Malaria, held in Paris in 2003, France announced that it was increasing its annual contribution from EUR 50 to 150 million. In early 2004, the President of the Republic joined with the President of Brazil and the United Nations Secretary-General in giving substance to measures to combat hunger launched in parallel with the G8 Summit in Evian. These measures will involve looking at different methods of financing aimed at strengthening international co-operation and launching public-private partnerships in order to set up a world fund to combat hunger.

The statements made by the President of the Republic have put France in the front line on the international stage and demonstrated the urgent need to act and to secure the means to combat injustices and pandemics throughout the world. Over and above the mere words contained in such statements, action strategies have been drawn up in a few leading areas such as the campaign against HIV/AIDS, access to drinking water and taxation in favour of global public goods.

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The general principles of development co-operation policy

Multiple objectives: a hindrance to having a unified view of French policy

The conclusions of the last CICID meeting (2002b) spelt out the two ODA priorities for the years ahead: Africa and NEPAD on the one hand and sustainable development on the other, measures to combat poverty being an integral part of this theme. Sustainable development encompasses five priority sectors: (i) water and sanitation, with the promotion of the principles of governance and the creation of innovative financial mechanisms to facilitate private investment; (ii) education, with the emphasis on the 'Education for All' Fast-Track Initiative; (iii) health and the measures to combat HIV/AIDS; (iv) agriculture and rural development; and (v) infrastructure, especially at regional level in response to the request made by NEPAD.

These priorities correspond broadly to the MDGs and to France's concern to see the emergence of a world where there is more solidarity between people and which is ecologically more responsible. However, because of the variety of its objectives and systems (see Chapter 5), French development co-operation policy does not project the sort of unified view which would suggest that achieving the MDGs is central to its action. This impression is reinforced by the many policy statements and works on the subject drafted during the past three years, and also by the nature of the missions entrusted to the main players in the French development co-operation system: the MAE's DGCID, the Treasury Directorate in the MINEFI and the AFD. The DGCID and the Treasury Directorate in particular have tasks which require them to assume responsibilities in areas other than development.

On the diplomatic front, the DGCID runs and co-ordinates all the international co-operation activities organised by the authorities and civil society. It also manages France's development assistance schemes and cultural, scientific and technical co-operation activities. What this shows is, first, that co-operation is a central feature of diplomacy and, second, that development assistance is dispersed within French foreign policy. From the point of view of the coherence of France's external activities, this is positive, with development co-operation less cut off and independent of diplomatic objectives than in the past. However, the two essential requirements that are development and the continuation or strengthening of France's influence in the world do maintain a degree of ambiguity. The twinning of 'solidarity and influence' expresses the difficulty of combining these two imperatives which are in fact not necessarily contradictory. Because there is no single institutional agency for development assistance, it may be that trade-offs do not always work in its favour, the priority attaching to it sometimes coming up against the 'arguments with more influence' (Réseau Impact, 2002).

The MINEFI contributes to development assistance and to thinking about the directions in which co-operation should go. The Treasury Directorate is responsible for macro-economic and financial aid which includes questions to do with debt reduction, investment promotion, export financing, monetary and financial co-operation with Franc zone countries and the monitoring of economic and financial relations with developing and transition countries. The Treasury Directorate is also responsible for managing contributions to multilateral funds and monitoring the development banks.

Where the AFD is concerned, the November 2001 mission letter addressed to the Director-General asked him to focus on three unifying themes: economic and financial stability, the environment and the reduction of social inequalities. In the *Projet d'Orientation Stratégique* (POS) adopted in 2002 (see Chapter 5), the Agency wanted to make French positions known in international circles, make use of its experience and know-how and develop innovative schemes. Its ambition is to become "an agency of international renown" and to develop experimental activities "that may serve as a reference for new international policies" (AFD, 2002a). It also proposes to meet the challenges

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facing French foreign policy (security-peace-stability, migration, global public goods and the promotion of French influence). Lastly, it intends to develop (public/private) partnerships which "alone are up to the challenges of mobilising savings and meeting the need for investment and efficient management". Its new range of financial instruments should enable the Agency better to adjust its responses to its partners' needs and to generate 'leverage'. The Agency's terms of reference are such that it intervenes both in the developing countries and in the Overseas Departments and Territories (DOM-TOM).

The CICID (2002a) was seeking to create a unified view of French development assistance policy when, on 14 February 2002, it asked the MAE and MINEFI to describe its "multilateral, Community and bilateral dimensions" in a clear manner. And a White Paper was in fact drafted with the Monterrey Conference in mind. The document, entitled "*La politique française d'aide au développement aujourd'hui: pour une mondialisation solidaire*", was not widely circulated and what will become of it is uncertain. And yet there are a number of reasons why it is vital to have a unified presentation of the thrust of French ODA policy. It would serve first of all to clarify France's geographical, sectoral and/or thematic choices in relation to the MDGs and the roles of the various institutions that make up France's development assistance system. Also, it would meet the concern, expressed on numerous occasions by parliament, French civil society organisations and various other circles, that the broad lines of French policy be brought together in a single document. Lastly, such a paper would have the advantage of attracting the attention of public opinion to aspects of French policy about which little is still known, but which nevertheless arouse considerable interest.

Despite the multiplicity of objectives, a number of principles do emerge

The fact that there are many French policies relating to co-operation does not mean that there is no complementarity or convergence at either the conceptual level or regarding the principles of aid implementation. Each of the above exists and concerns the following fields: political – international solidarity, peace, stability, reconstruction and governance, in particular sound public management and the promotion of democracy; economic – with the accent on distributive growth and the role of public-private partnerships; and social – regarding access to basic services (health, education and water). They concern both the international dimension (sustainable development, global public goods, regulation of globalisation and cultural diversity) and the regional and sub-regional levels (support for NEPAD and African institutions). The said complementarity and convergence plead in favour of strengthening partnerships with both the public authorities and the OSIs, the territorial authorities and other bilateral and multilateral donors, notably in the framework of the strategies developed by partner countries.

(i) Continued priority in Africa

With its special historical ties with the African continent, France constantly pleads Africa's cause in international fora and also in the context of the efforts made to solve the debt problems of the poorest countries. It is in favour of integrating the least developed countries (LDCs) in the globalising world from which they are excluded. It is helping to promote the macroeconomic adjustments made under the aegis of the International Financial Institutions (IFIs). Under the heading of monetary co-operation with the Central African Economic and Monetary Community (CAEMC) and the West-African Economic and Monetary Union (WAEMU), France also has a special responsibility for the economic and financial stability of the countries of Central and West Africa. Since the Franco-African Summit at La Baule in 1990, it has been pleading the cause of democracy and respect for human rights throughout the continent. Lastly, in the context of the Cotonou Agreements, France played an active part in introducing the partnership concept in the political dialogue with the EU.

Sharing, as it does, in the determination to build a new relationship between Africa and the world through partnership, France subscribes fully to the 'spirit of NEPAD'. At an initial meeting of the G8 and the IFIs, organised in Paris in March 2003, it was confirmed that priority was being attached to a continental infrastructure policy. A further meeting, in November 2003, extended the dialogue to the leading donors. The AFD's terms of reference, in particular, mean that it is concerned with several of NEPAD's sectoral priorities, especially regional infrastructure (electricity, transport and drinking water), education and health, the mobilisation of local financial resources, the environment and natural resource management.

France also supports the regionalisation process in sub-Saharan Africa: convergence of macroeconomic policies; introduction of unified laws and a shared court in 16 countries thanks to the Organisation for Harmonisation of African Business Laws (OHADA); harmonisation of the banking and insurance sectors; development of economic, social and environmental statistics and increased skills in this area.

France is highly interested in an integrated approach to development, encompassing the notions of peace and security. It is very much present in Africa in terms of furthering efforts to promote peace and stability, and has restated its intention to assist the regions in crisis first and foremost (Villepin, 2003). Its involvement in this field rests on three principles: (i) the legitimacy of the regime, with the emphasis on elections and the establishment of the institutions of State; (ii) respect for national sovereignty and territorial integrity, with support for efforts to further regional integration; and (iii) the vital role of African mediation, with France encouraging the efforts of the African Union and other institutions to set up effective mechanisms for conflict prevention, management and settlement.

To reinforce peace and stability in Africa, France has undertaken to train, equip and fund regional defence forces (see Box 2). Civilian and military co-operation contributes to crisis solution processes, including the reintegration of rebel forces and child soldiers. France backs reconstruction efforts involving the strengthening of administrations and communications channels. In Brussels, finally, it is in favour of financing an African peace-keeping capability and is mobilising the international community on these issues.

Box 2. Reinforcement of African peace-keeping capabilities (RECAMP)

Under the aegis of the United Nations, the RECAMP programme is France's contribution to the efforts made by the international community to enhance Africa's peace-keeping capabilities. The programme is in three parts: (i) training in peace-keeping skills, which is dispensed in France's various military academies or has French backing; (ii) training in the form of politico-defence seminars and field exercises; and (iii) the equipment needed to carry out various missions such, for example, as in the Democratic Republic of the Congo.

The RECAMP programme is based on: (i) multilateralism, which sets it apart from the usual bilateral military co-operation and is reflected in the choice of the sub-region as the preferred theatre of action; (ii) openness – all countries which so wish being in principle able to to participate; and (iii) transparency, the activities pursued being known to all and accessible by everyone. RECAMP is designed to ensure a lasting partnership with the African countries, which will be capable of meeting their expectations and needs.

Statement by the Ministry of Foreign Affairs spokesman, 16 May 2001.

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(ii) 'Francophonie' and cultural diversity

Of prime importance in France's co-operation policy, *Francophonie* – meaning all the measures to promote French and the values that it conveys – is closely bound up with external cultural activities. The latter are many and varied, but their strategic thrust is twofold: to promote the influence of the French language and culture in the world and encourage intercultural dialogue as a genuine response to the challenges of globalisation. These activities are carried out in French cultural centres, the various *Alliances françaises*, French *lycées* managed by the *Agence pour l'enseignement français à l'étranger* (AEFE) and the co-operation and cultural action services of French embassies. Through the *Agence de la francophonie*, France encourages schemes relating to: (i) peace, democracy and human rights; (ii) cultural diversity and intercultural dialogue; (iii) sustainable development; and (iv) access to training and information.

(iii) The environment and sustainable development

One of the components of 'France's identity with regard to development' is sustainable development, which the CICID would like to see as an integral part of the thinking of all the development actors – both governmental and non-governmental (CICID, 2002a). It in fact asked them all to include sustainable development indicators in project evaluation by 2004.

France's action in this field is guided by the principles expressed at the 1992 Rio Summit, the concept having spawned a series of multilateral conventions on climate, desertification and biodiversity. The activities of the MAE are focused on the environment, economic development and social development, with the cross-cutting concern to consistently favour good governance (Wiltzer, 2003). Considerable importance is attached to questions concerning water, food security and agriculture – in Africa in particular. There is support for the management plans for all of Africa's river basins, which have to be drawn up before 2005. Also, in line with the action plan prepared at the G8 Summit in Evian, the MAE is pursuing a policy of international scientific co-operation aimed at promoting sustainable development in the farm sector by linking productivity and the preservation of biodiversity.

The AFD has done extensive work in this area, with activities relating to water, biodiversity, measures to counter desertification, climate change, fisheries and the marine environment and economic analysis. It acts as the secretariat for the French Global Environment Facility (FFEM) which is in favour of environmental challenges being taken into account at world level. At the organisational level, an environment 'pole' within the directorate for strategy is asked from time to time to give its opinion on large-scale projects, while an environment and natural resource management division pronounces on the terms of reference and conclusions of the environmental studies required in connection with projects with a substantial environmental impact.

(iv) Global public goods

France has become involved in the debate on Global Public Goods (GPGs)[1] via environmental issues, since the concept was first introduced by the United Nations Development Programme (UNDP) in 1999. French concerns centre on the world environment, health, food security, support for regional economic integration, research into development and the promotion of cultural and linguistic pluralism (MAE/DGCID and MINEFI/Direction du Trésor, 2002). France's most recent involvement dates from

1. Global public goods encompass (MAE/DGCID, 2000a): 'environmental' goods (climate and the ozone layer), 'human' goods (scientific and technical knowledge, world cultural heritage and transnational infrastructure); and world political issues (peace, health and financial stability).

2003, when it was part of a Franco-Swedish working group on the collective management of global problems. The group, which comprises some 20 very high-level individuals, is talking about introducing tax mechanisms to regulate the excesses of globalisation and finance the production of GPGs, particularly for the benefit of the developing countries. The said mechanisms could cover international financial transactions, arms sales, credit card payments, air transport, oil and the developing countries' debt service payments to the wealthy countries. Encouraged by the President of the Republic, a multidisciplinary working party has also been given the task of producing some concrete proposals in this area as soon as possible.

(v) Democratic governance

According to a recent strategy paper, the concept of democratic governance is set to "refresh French development co-operation policy" (MAE/DGCID, 2003b). An ambitious work programme is proposed, including the creation of a 'governance' unit in the DGCID, a new method of programme identification, new implementation tools and a systematic monitoring method.

The DGCID cites the importance of political factors and institutions "by comparison with the exaggerated importance of economic factors" and describes democratic governance as a series of interconnected elements: (i) universal democratic values; (ii) a state as the guarantor of the general interest; (iii) the strengthening of countervailing powers; (iv) the principles of good public management; (v) the decompartmentalisation of sectoral policies; (vi) regional integration; (vii) policy harmonisation; and (viii) the ownership principle. It suggests "a responsibility ethic" and the end of "archaic forms of domination or impoverished forms of cultural and ethnic homogeneity". This is a vision of globalisation that France is anxious to promote via "more equitable and peaceful" world integration.

The challenges are immense and the answers are not homogeneous. France, for its part, proposes that:

- Democratic governance be put at the heart of poverty reduction strategies in every country and at international level so as to bring transparency to financial, monetary and trade systems.
- Public policies to 'restore the right of the weakest to have access to global public goods' be sanctioned.
- Democratic governance be incorporated in public policies, including at local level and in regional and sub-regional institutions which 'are beginning to devise strategies in favour of local authorities'.
- Social cohesion be strengthened in order to 'prevent or reduce vulnerability to catastrophes and conflict exacerbation'.

The document in question is the outcome of protracted thinking and consultations between academics and practitioners in the North and the South, with the result that it has conceptual as well as operational qualities. It takes a critical look at some of the mistakes made in the past, most of which involved transposing systems, procedures and norms that were often ill suited to the situation in partner countries. It takes as its starting point the principle that democratic governance has to be in the hands of national actors, whether governmental or not. This means moving away from the methods and cultural environment of western democracy and closer to local customs and practices. This encouraging vision could result in far-reaching changes in French aid practices.

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Support for development co-operation

Combating hunger and poverty: one of the concerns of French public opinion

The last DAC review said that there was no systematic government policy of informing public opinion and making it aware of development issues "despite strong demand among non-governmental actors for greater transparency". Although measures to remedy this have been recommended, the government has not undertaken any continuous programme of research into French public opinion on development matters (OECD/Development Centre, 2003).

When questioned in 2001 about their perception of ODA, the majority of respondents said they were dissatisfied with the amount of French aid, judging it to be insufficient (BVA, 2001). The latest barometer of international solidarity, produced in 2003, shows that hunger is one of the causes that the French are most willing to give for. It is not seen as inevitable, which means that "it is the methods used by international agricultural trade that would seem explicitly to be called in question" (BVA, 2003). Also, a very large majority of French people (88% of those asked) consider action in the field to be the most effective way of combating world hunger, while 65% of them see food self-sufficiency as vital if the poor countries are to develop. The involvement of the French in this area can be gauged from their willingness to commit themselves at both national and personal levels. This willingness has been on the rise since 2001 and the trend seems to have been confirmed in 2003 with the increase in pledges to make donations and purchase fair trade goods. It is interesting to observe that the French are extremely sceptical about the role of IFIs, the G8 and multinational enterprises in combating world hunger and poverty (BVA, 2003).

Increased dialogue with French civil society

In recent years the French authorities have established a steady and positive dialogue with French civil society organisations. It takes place either directly or in the framework of advisory bodies such as the HCCI, the National Commission for Decentralised Co-operation (*Commission nationale de la coopération décentralisée)* or the Development Co-operation Commission (*Commission coopération-développement*). The interest shown by the public authorities should not hide the fact that the share of French ODA that goes through the international solidarity organisations (OSIs) is still one of the smallest in the donor community (see Chapter 2). In addition to increasing their financial support for OSI players, the authorities need to involve them more extensively in defining sectoral and geographic strategies when the said organisations appear to be relevant negotiators.

In 2002 the HCCI began its second mandate, with a few changes in its composition and role, but its main responsibilities remain the same, namely to foster consultations between development co-operation actors and heighten public awareness as to the challenges that it represents. Until recently, the High Council organised annual events designed to compare ideas with those of foreign institutes and experts and other French public and private bodies. In the course of its first mandate, it handed down over twenty opinions and contributions, two-thirds of them at the request of the government or the National Assembly's Finance Committee (HCCI, 2003). A number of these opinions sum up the fruit of its thinking in various areas (NEPAD, sustainable development, governance, human resources, health, higher education and research).

Despite being seen by some as a "think tank", the HCCI must not monopolise the debate with the French government. The AFD has its own sphere, "the OSI Club". The MAE, the MINEFI and other ministries have also set up consultation bodies specific to certain issues. So the movement that began with the reform has progressed over the past five years. At the same time, people from government, research and/or civil society, experts and practitioners have set up networks to reflect on other

development models and identify interesting experiments which could help French co-operation to move forward. The recommendations originating from these networks are to be found in a number of strategic and thematic papers. Bringing all the experience gained in the field back up to the top is always one of the main difficulties that French co-operation has to contend with. The above networks play a positive role in comparing ideas and spreading good practices.

Dynamic decentralised co-operation

Decentralised co-operation is specifically French and an important factor in heightening public awareness. Under the 1992 Act on the territorial organisation of the Republic, French territorial authorities (regions, *départements*, urban communities and communes) are authorised to pursue co-operation-related activities with foreign territorial authorities. This form of co-operation is nowadays extremely dynamic. At its last meeting, the CICID expressed the hope that consultations between local authorities and other actors (the state, the AFD and multilateral donors) might be improved and that the procedures for approving projects financed jointly by the state and the corresponding delegated appropriations funds might be simplified.

A questionnaire prepared by the HCCI (2004) on decentralised co-operation practices pursued for purposes of development and international solidarity reveals four main trends. The first is that the vitality of this form of co-operation is attributable to the "political will" of either a group of elected officials and motivated members of civil society, or a local personality. The second is that it is difficult to have an overall idea of its scope, whence the feeling of dispersion "prejudicial to the perception of the role that it can play in international co-operation". The third recognises that relations between French local authorities and those in the host country can be "inegalitarian", thus undermining the principle of partnership. The fourth conclusion is that it is, more often than not, the OSIs that are the real vectors of relations between authorities.

Other perspectives (Husson, n.d.) suggest that while decentralised co-operation does help to bring actors from different worlds closer together, it often gives way to 'arguments with more influence' and results in the transfer of a model, for example at the level of producer organisations, chambers of agriculture, justice and decentralisation in particular. Everbody agrees about the need for the actors involved to knit together and for the activities in which they are engaged to be catalogued. Activities under the heading of decentralised co-operation should be assessed and linked more effectively with national measures to combat poverty.

Local authorities are well aware of the need to improve their practices. At a forum in 2003,[2] they undertook to: catalogue ongoing activities in a comprehensive data base; make host country governments aware of what this form of co-operation involves and what criteria determine its success; identify good practices by groups of actor and by major field of action; propose more suitable shared tools (financing, partnerships, follow-up, evaluation and communication); and circulate their reports in the consultative bodies.

2. 5th Conference on Franco-Vietnamese co-operation, Toulouse, 13-14 October 2003.

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Points for consideration

- The French authorities should begin preparing a guidance and strategy document covering the ODA system as a whole. Built in particular around achieving the MDGs and based on the principle of aligning French co-operation on the poverty reduction strategies put together by recipient countries, the document in question would act as a joint platform for ministries, public, private and voluntary sector operators and serve as a common language and communication tool at national and international level.
- The cross-cutting policy document planned by the LOLF could provide a useful framework for dissecting the global strategy into budget options.
- The two documents and the drafting process involved could serve as a starting point for involving the OSIs in developing and then implementing policies and strategies, and also for heightening public awareness concerning the implementation of the MDGs.

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CHAPTER 2

VOLUME AND DISTRIBUTION OF AID

Total volume

Increasing official development assistance: a government priority

In 2002, the volume of French ODA – USD 5.49 billion – made France the third biggest donor among the 22 DAC member countries (see Figure C.1, Annex C). As a percentage of GNI, France was in the upper rank of G7 countries, with a ratio of 0.38%. This was above the DAC average of 0.23%, but lower than the average by country (not weighted by the DAC country ratios) which was 0.41%.

In 2002, France has undertaken to increase its ODA by half over the coming five years, the target being to reach 0.5% of GNI by 2007, which is the first stage on the way to the 0.7% target set by the United Nations, which should be achieved by 2012. It is well on the way to meeting its commitments. French ODA began to grow again in 2001 (see Figure under Table C.1, Annex C), after declining by nearly 50% during the second half of the 1990s (the ODA/GNI ratio falling from 0.64% in 1994 to a low of 0.32% in 2000). In 2002 it rose substantially, with an increase of 22% in real terms and a rise in the ODA/GNI ratio from 0.32 to 0.38% (see France's Aid at a Glance). In 2003, the freeze and then cancellation of the ODA appropriations voted by Parliament resulted in the funds available declining by more than 20%. Despite a difficult budgetary situation, ODA should continue to increase in the years ahead since it was one of the government's four budgetary priorities in 2004.

Caution is needed when predicting the trend in French ODA. An appreciable share of the present increase is attributable to the process of debt cancellation in the context of the HIPC initiative. The amount of ODA devoted to debt treatment totalled USD 1.5 billion in 2002 (at constant prices), i.e. almost one quarter of ODA. According to the 2003 and 2004 Finance Bills, the amounts involved were EUR 1.9 billion in 2003 and probably in excess of 2 billion in 2004. For the time being, the increase in ODA has hardly led to any flows of new money to the developing countries. As a result, the present scale of debt reduction has not as yet allowed the increase in ODA to be used, via the appropriate budgetary options, to further the strategic orientations of French co-operation, including achieving the MDGs.

The perpetuation of ODA, with the gradual completion of the HIPC initiative, raises a number of questions. In the near future, once the majority of HIPCs have been through all the stages in the debt reduction process scheduled under this heading, it is to be expected that there will be an appreciable decline in the debt cancellation effort. It will then become necessary to find alternative ways of maintaining ODA levels. Mobilising budgetary resources, programming them and deciding how they should be implemented, quite apart from the human resource requirements, are challenges which the DAC would encourage the French authorities to give their attention to without delay.

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Distribution of ODA

Between them, the MAE and the MINEFI control over 90% of ODA (see Table 1 below). The Ministry for Youth, National Education and Research plays a relatively important role as regards technical co-operation through the medium of the research budget which mainly benefits two bodies: the Development Research Institute (*Institut de Recherche pour le Développement*, IRD) and the French Agricultural Research Centre for International Development (*Centre de coopération internationale en recherche agronomique pour le développement*, CIRAD). In addition, it covers the higher education costs of students from countries eligible for ODA. In terms of budget appropriations, the AFD's capital represents only 3% of total ODA, whereas the ODA disbursed by the Agency (EUR 509 million in net terms and EUR 816 million in gross terms in 2002) amounts to some 10%.

Table 1. Breakdown of ODA

EUR million, net 2002 disbursements

	MINEFI	MAE	AFD	Other ministries	Total	In %
I. Bilateral aid						
Technical co-operation		577		945	1 522	26
Projects and programmes	-44	347*	169		472	8
Debt relief	1 140				1 140	20
Emergency aid and food aid		29		278	307	5
TOM (Mayotte and Wallis and Futuna)				188	188	3
Administrative costs				206	206	4
Total bilateral	**1 096**	**953**	**169**	**1 617**	**3 835**	**66**
II. Multilateral aid						
European aid	770	595			1365	23
Dev. Banks and Funds	495				495	9
UN institutions		126			126	2
Total, multilateral	**1 265**	**721**			**1 986**	**34**
III. TOTAL	**2 361**	**1 674**	**169**	**1 621**	**5 821**	
In %	40	29	3	28		

Source: MINEFI, OECD.

* This amount includes a budget allocation of EUR 190 million for financing AFD and C2D grants.

Programming and the budgetary process: the lack of visibility of ODA

The clarity of French aid to the developing countries is not helped by the fact that there is no overall presentation of co-operation policy, nor any annual report. The medium-term trend in ODA is not really perceptible, no forecasts having been published despite the CICID's undertaking to do so in 2002. What is more, the government has no multi-annual programming framework.

With the current budgetary presentation, it is not possible to distinguish clearly which international co-operation activities come under the heading of ODA. The CICID had undertaken to present the budget in a more transparent manner in the context of the 2003 Finance Bill, but its efforts were found wanting (National Assembly, 2003). Also, a large proportion of France's ODA, as notified to the DAC, is not the subject of any budget posting in the framework of the Finance Bill on appropriations for co-operation with the developing countries. The difference in 2004 is thought to be nearly EUR 3.5 billion, *i.e.* over half of ODA (Senate, 2003). This discrepancy is attributable in part to operations going through the special Treasury accounts – especially those intended for debt treatment

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operations – and to the inclusion of certain *ex post* expenditures coming under the heading of ODA according to the DAC definitions. The latter include: the share of France's budget contribution allocated to the development activities of the European Commission outside the sphere of the European Development Fund (EDF); the costs induced in France by students from developing countries; the cost of assisting refugees during their first year in France; and administrative costs.

External cultural activities and the promotion of the French language and culture (*Francophonie*) are an important part of French co-operation, coming mainly under the responsibility of the MAE. In terms of results and impact, however, they are amongst the least well assessed aspects of French co-operation, despite the resources devoted to that end. It would seem that the number of superimposed structures and the extent of all the activities represent a cost that has not been calculated, which would justify carrying out an in-depth analysis of the effectiveness of the measures taken in this area. What is more, the diversity of activities and multiplicity of actors, combined with the lack of any strategic presentation, make it difficult to identify easily what belongs to ODA.

In 2002, the budget for external cultural activities came to EUR 1.3 billion, of which 914 million for *Francophonie*. These figures need to be compared with, for example, the measures to promote the developing countries' own culture (EUR 3.9 million of FSP commitments in 2002). The breakdown of the DGCID's budgetary resources (two-thirds of which come under ODA) shows to what extent development has been diluted within cultural action (see Table 2). Less than one-third of these resources go to activities which contribute directly to poverty reduction and to achieving the MDGs (see the heading "FSP" and "AFD" grants, "development and technical co-operation" and "non-governmental co-operation").

Table 2. DGCID budget

Sectoral breakdown of resources in the 2002 budget	EUR million	In %
French *lycées* and *collèges* abroad	314	22
FSP and AFD grants	254	18
Cultural co-operation and French language	202	14
Development and technical co-operation	191	13
External audiovisual and communications technology (including TV5 and RFI)	188	13
University co-operation and research	161	11
Non-governmental co-operation	34	2
Miscellaneous	83	6
Total	1 427	100

Source: MAE/DGCID, Bilan 2002 et perspectives.

Against this background, the LOLF is a major innovation (see Box 3). It should make government action more transparent and, at budget level, allow the exact amount of expenditure corresponding to each public policy to be identified. In this connection, the implementation of the LOLF is a significant step towards increasing parliamentary control. The planned new presentation of ODA covers only 42% of the ODA effort[3] since it includes neither the special Treasury accounts nor the expenditure recorded *ex post* as ODA. It is important that the substantial sums that France devotes to debt relief and to the European Commission budget – which for technical reasons are not included in the central government budget – be reflected in the documents concerning the 'official development assistance' mission, and especially the cross-cutting policy document. This remark also applies to the other categories of ODA entered in the budgets for other missions (such as the imputed costs of

3. On the basis of the 2003 Finance Act.

students and of refugees), so that as comprehensive as possible a description can be given of overall French ODA. Some of the innovations scheduled under the LOLF, such as the introduction of a 'country-budget', are relevant to ODA. The said country-budget will enable the Ambassador to have an overall view of France's expenditure in a given country.

Box 3. Institutional Act on Finance Legislation (LOLF)

The LOLF was adopted by parliament in 2001 with the object of changing the presentation of the budget and modernising public management. What it means is that, with effect from 2006, central government will move from resource management to management based on objectives, the latter being set in advance and measured by performance indicators. The LOLF ought also to give the government greater freedom of action thanks to the fungible nature of appropriations, which will allow them to be redeployed between different activities – with the exception of expenditure on personnel, including technical assistance, on which there is a ceiling.

The new budget structure, approved by the prime minister in January 2004, consists of a budget made up of 45 missions, themselves divided into programmes which are split into activities and sub-activities. Each mission tallies with a public policy which may be divided between several ministries. Where interministerial missions are concerned, policy co-ordination will be in the hands of a leader whose task it will be to ensure policy co-ordination, while a cross-cutting policy document will supplement the budgetary information contained in the Finance Bill.

Following the consultations between the MAE and MINEFI with regard to consolidating the whole of the ODA budget, the new budget presentation[1] includes an 'official development assistance' mission which is the responsibility of both ministries. The mission is made up of two programmes: i) economic and financial development assistance; and ii) solidarity with the developing countries. The person in charge of this mission will be appointed in the coming months. An 'external government action' mission, coming under the MAE, is also being contemplated. This contains three programmes: i) French action in Europe and the world; ii) cultural and scientific outreach; and iii) the French abroad and foreigners in France.

Implementing the LOLF requires considerable political will because it involves a radical change in public management methods. Far-reaching projects are in progress: restructuring the budgets; the establishment of new management methods; changes in human resource management; the introduction of performance measurement and management control; changes in accounting; and an overhaul of information systems.

1. Available on the MINEFI web site: www.MINEFI.gouv.fr/moderfie/architecture/index documentation.html.

Bilateral ODA

The decline in French aid observed between 1995 and 2000 mainly concerned bilateral ODA. The withdrawal of New Caledonia and French Polynesia from Part I of the DAC list of aid recipients contributed to the continuing fall in ODA in 2000. Restoring bilateral ODA to its dominant position is one of the government's stated priorities. Its share in total gross ODA rose from 66% in 2001 to 70% in 2002 and ought to stabilise at that level (see Table C.2).

Part of French aid (12% of total gross ODA) is in loan form (see Table C.2). In countries which are at the same time HIPCs and LDCs, the AFD provides grants or non-sovereign loans which go to market sectors and do not require a government guarantee. It can also grant loans on very concessional terms to HIPCs that are not LDCs. In order to avoid AFD risk being too highly concentrated in a limited number of countries (because of the drastic reduction in the number of countries eligible for loans) the CICID has since 2002 authorised the Agency to intervene outside the ZSP in the Mediterranean Basin (Egypt, Jordan, Syria and Turkey) and the Greater Mekong region (Yunnan Province in China). The MINEFI grants loans under the heading of the Emerging Economies Fund

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(RPE), with the main criteria being that: i) the projects concerned should have a strong leverage effect on the recipient country's development; and ii) French technology and know-how should be used in implementing the project, bearing in mind the requirements and the ability of the contractors to manage this know-how from both the financial and the technical standpoints (see the list of eligible countries, Annex B). Disbursements fell from EUR 240 to 154 million between 1999 and 2002.

The burden of debt treatment

Technical co-operation is a major component of French aid, accounting for 23% of total ODA (see Table C.2). It mainly consists of technical assistance, educational grants and courses, research activities and the costs in France arising from foreign students from countries eligible for ODA. In contrast, the resources allotted to the 'programme and project aid' category account for only 7% of total ODA (see Table C.2).[4] Project aid comes from various sources: the FSP – run by the MAE, the AFD and the RPE. France tends to favour project aid, but does not rule out the programme approach (see Chapter 6 for a description of these different instruments).

Debt treatment

France is one of the developing countries' biggest creditors and for a number of years the treatment of their debt has accounted for a large proportion of its ODA. In 2002, it represented 24% of total ODA (see Table C.2) and 25% of the total effort by all DAC member countries.[5] It is not possible, with the data available, clearly to identify either the allocation of funds freed up by debt relief by country and by sector, or the nature of the debts cancelled.

Within the Paris Club, France plays a central role in the treatment of developing country debt. It has always backed the international community's efforts to find a solution to these countries' excessive indebtedness. It is also taking part in the ongoing discussions in the IFIs concerning the debt sustainability of HIPCs. With regard to the debt of countries not eligible for the HIPC Initiative, France made proposals in the context of the 2003 G8 Summit, which led to the adoption of the Evian approach.

The overall cost of the debt relief granted by France under the HIPC Initiative is estimated at over EUR 10 billion. This is made up of: (i) a EUR 200 million contribution (of which 90% via the European Commission) to the HIPC Trust Fund, managed by the World Bank; (ii) commercial debt relief of EUR 5.5 billion handled within the Paris Club; and (iii) like the majority of G7 countries, an additional EUR 1 billion effort to achieve 100% cancellation of the commercial debt eligible for Paris Club treatment, and EUR 3.7 billion to cancel all ODA debts.

4. The DGCID estimates that nearly two-thirds of technical assistance, or EUR 185 million, goes directly to project and programme implementation. It is considering changing the way the DAC is notified of this, which would give a better idea of its activities.

5. See Table 14 (OECD/DAC, 2004).

With regard to the cancellation of ODA debts, France has opted for a refinancing mechanism which consists of making grants of the payments due by the countries concerned. This formula allows debt repayments to be converted into grants used to finance poverty reduction programmes in the framework of PRSPs. This necessitated the introduction of Contracts for Debt Reduction and Development (C2D) (see Box 4). France is putting a great deal of effort into this new instrument which is enabling it to test the implementation of the programme approach. For the moment, five contracts have been signed representing total commitments of EUR 62.4 million over the period 2001-2006, *i.e.* less than one-third of the cumulative outstanding payments. There is still uncertainty as to which countries will be the biggest potential beneficiaries of C2Ds: Cameroon and the Côte d'Ivoire, each of which has ODA debt of approximately EUR 1 billion.

Box 4. Contracts for Debt Reduction and Development (C2D)

C2Ds are three-year contracts between the French government and the recipient government. They are signed as soon as the country concerned reaches the completion point of the HIPC Initiative. The recipient government continues to make its repayments to the Bank of France in the normal way but in return, in a joint account opened with its central bank and requiring the signature of both its designated authority and that of the AFD, it receives an amount corresponding to the payment it has just made. Based on the loan repayment dates, the C2D process can be spread over forty years (there can be several consecutive contracts in the same country) and represents a projected financial amount of some EUR 3.7 billion.

C2D resources are used to support sectoral programmes in the following areas: basic education and occupational training; primary health care and measures to combat the major endemic diseases; local authority plant and infrastructure and physical planning; and natural resource management. Responsibility for C2D programming is shared by the MAE and MINEFI, while implementation comes within the sphere of the AFD. Civil society organisations are involved in the process of drawing up and monitoring contracts. A project research and preparation fund has been set up to this end for the preparation of the C2D in Cameroon.

At present, 22 countries are eligible for a C2D (see Annex B). Five have already signed contracts (see table below), while C2Ds are being prepared for Cameroon, Madagascar and Nicaragua, all three of which are close to the HIPC completion point.

Countries that have signed C2Ds with France	Period	Amount of 1st contract	Stock of ODA debt to be refinanced in grant form
		EUR million	
Mozambique	2001-04	29.8	79
Uganda	2002-05	3.2	13
Bolivia	2003-06	10.5	28
Tanzania	2003-06	4.2	11
Mauritania	2003-05	14.7	70
Total		**62.4**	**201**

Source : MINEFI.

Non-governmental and decentralised co-operation

The government has on various occasions said that it wants to encourage more wide-reaching participation by civil society and the territorial authorities, but these declarations of intent do not seem to be resulting in any significant increase in the resources placed at their disposal. The amount of ODA going to NGOs, which was USD 28 million in 2002 (in constant prices), accounted for less than 1% of total ODA, *i.e.* one of the lowest percentages in the DAC (see Table C.2). The NGOs have devoted

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some thought to cofinancing arrangements which would enable them to absorb a possible increase in the resources made available to them (*Coordination SUD*, 2004). These could take the form of global multi-annual appropriations intended to finance geographic or thematic programmes, with increased *ex post* controls. The advantage would be to enhance the strategic compass of cofinancing, while at the same time making it easier to manage administratively. Within the framework of the FSP, a relatively large share (26% of commitments in 2002, or EUR 40 million) goes to activities aimed at strengthening civil society (French NGOs and territorial authorities).

The NGOs have had great success in mobilising private resources, thereby doubling their volume of activities in ten years so that the figure now stands at EUR 700 million. Twenty NGOs share 80% of these resources. Whereas private financing accounts on average for more than 60% of the NGOs' overall budget, the share of French official cofinancing accounts for less than 10% of their global budget, the remainder coming from the European Commission and international organisations.

Currently, more than 3 000 territorial authorities are thought to be active in the field of decentralised co-operation in 115 different countries. In view of the abundance of activities and the number of operators involved, it is difficult to carry out an exhaustive inventory of this form of co-operation. It is estimated that the amounts raised via local authorities, all sources of financing combined, could reach a total of over EUR 200 million per year. For the time being, this amount is not counted in the figures for French ODA. The government is encouraging the growth of decentralised co-operation by giving its backing to territorial authority projects in the form of cofinancing (EUR 8 million split between 300 projects in 2002).

Inadequate geographical selectiveness

The 1998 reform established the ZSP with the object of making French aid more selective and concentrated. The 54 countries on the list (see Annex B) include the least developed countries without access to the capital markets. The list comprises the "ambit" countries,[6] to which have been added a sizeable number of other sub-Saharan and Maghreb countries, Lebanon, the Palestinian-administered territories, Yemen, the countries of the Indo-Chinese Peninsula, Vanuatu and Surinam. The list changes in that it can be altered every year by the CICID, and it was in fact shortened from 61 to 54 countries in 2002. The ZSP is first and foremost a political concept and does not guarantee that the countries in question will receive a predetermined amount of French aid.

In the context of the impetus given to its aid programme, France has repeated that it intends to attach priority to Africa, undertaking to provide it with at least 50% of the amounts deriving from the growth of ODA. The geographical breakdown of bilateral ODA (see Table C.3) shows the heavy concentration in Africa, whose share of bilateral aid in gross terms rose from 62% in 1999 to 76% in 2002. By way of comparison, the DAC average in 2002 was 36%. In contrast with the past, the share going to sub-Saharan Africa is on the increase (from 45% in 1999 to 62% in 2002), while North Africa's share is declining (from 18 to 14% over the same period).

In restating the priority that it attaches to Africa, France undertook to assist the LDCs, two-thirds of which are there. In 2002, 33% of its bilateral ODA went to the LDCs (compared to the DAC average of 29%) and 33% to the other low-income countries (DAC average 31%) (see Table C.3). These percentages are up, the increase appearing to be more marked for the other low-income countries than for the LDCs. In line with its commitments, France is getting closer to the international target of 0.15% set by the United Nations. As a percentage of GNI, French ODA to the LDCs stood at

6. *I.e.* the countries formerly under French influence – mainly the ex-colonies in Africa.

0.11% in 2002, which is higher than the DAC average (0.05%). There is, however, room for progress in that only seven among the twenty biggest recipients of French ODA are LDCs.[7]

France has stated its determination to avoid spreading aid too thinly, but the reality is rather different. While 73% of bilateral ODA is concentrated on the 20 main recipients, the remaining 27% is spread over more than 120 countries. The share of bilateral ODA going to the ZSP countries is increasing – from under 50% in 1999 to 63% in 2002. But the 20 leading recipients of bilateral ODA include six countries which do not belong to the ZSP (see Table C.4). Also, some 20 ZSP countries receive annual amounts of less than USD 10 million. This is because the ZSP involves only AFD and FSP activities, which represent no more than a fraction of bilateral co-operation, while debt reduction and cultural, scientific and technical co-operation are not confined to the ZSP. In 2002, moreover, the AFD was authorised by the CICID to pursue its loan activities outside the ZSP so as to spread its risk. Since 2000, the FSP can also be used outside the ZSP for one-off schemes in countries emerging from crisis (south-east Europe and Afghanistan).

While the intention of the French authorities to concentrate aid on the countries most in need is increasingly evident, the principle has not actually been conceptualized (MAE/DGCID, 2003a and MAE/DGCID, MINEFI/*Direction du Trésor* and AFD, 2003). Like other DAC members which have decided what countries they wish to have a preferential relationship with, France could devote some thought to the advisability of establishing priorities within the ZSP, drawing up resource allocation criteria on the basis of what is required to achieve the MDGs. Other criteria could include policy achievement, good governance and respect for human rights. The AFD's Strategic Plan contains measures along these lines. Seeing that its resources were spread too thin among the ZSP countries and that its position in most of them was marginal, the Agency has drawn up a more selective geographical strategy, but neither the criteria on which the nature of co-operation is based, nor the resulting list of countries, have been made public.

Sectoral distribution: a trend in favour of the basic social sectors

A significant development since the last DAC Review has been France's marked commitment to the basic social sectors. A number of priorities have been made known at recent international events, this being the case as regards HIV/AIDS and water. France is now in a position to provide statistical information on basic education and health. The "infrastructure and social services" category is the most important component of French bilateral ODA, with 36% of the total (see Table C.5), and education alone accounts for 22%. Despite the efforts made in favour of general and basic education in a number of partner countries, and especially the support for the fast-track initiative in favour of Education for All (see Chapter 3), aid to the developing countries' education systems makes up less than one-quarter of all the resources allocated to education. The bulk of the resources reported in this category (USD 926 million in 2002) are made up of: imputed student costs (USD 562 million); transfers to the TOMs (USD 141 million); and the enrolment of national students in French *lycées* located in countries on Part I of the DAC list of recipient countries (USD 102 million).

France is one of the few DAC members (together with Austria, Canada and Germany) to include imputed student costs in ODA. The latter correspond to the cost to the French government of covering the higher education expenses of developing country students who enjoy the same subsidies as their French counterparts. The amounts involved are relatively substantial (USD 562 million in 2002, *i.e.* some 10% of ODA) and have increased (by 21% in 2002). They correspond to 145 000 students (75% from Africa, of whom more than half from the Maghreb countries). It is difficult, for want of detailed

7. In 2001-02 these were: Mozambique, Senegal, Mali, Burkina Faso, Madagascar, Benin and Niger (see Table C.4).

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information on the subject, to gauge whether notification is consistent with the DAC Directives in terms of student and study programme selection. In principle, the data should be adjusted in such a way as to remove from the accounts the imputed costs of students who do not go back to their countries of origin.

Multilateral ODA

The level of multilateral aid remained constant despite the decline in ODA between 1995 and 2000, its share in total ODA rising from 24% in 1998 to 34% in 2001 (see Table C.2). However, that trend is in the process of being reversed, the share having fallen back to 30% in 2002 (a level slightly higher than the DAC average of 27%),[8] even if the amounts are up in absolute value terms. As in the case of a lot of EU Member states, one of the features of French multilateral aid is the predominance of European aid.

France recognizes the importance of international organisations in coping with world challenges requiring solutions at multilateral level. It has undertaken to play a more influential role in international fora, but does not have an explicit strategy as regards its multilateral co-operation, the choice of institutions that it supports and the level of its contributions not appearing to correspond to clear policy options. France does, however, pursue relatively active policies at multilateral level, providing substantial aid to world funds such as the Global Fund to Fight AIDS, Tuberculosis and Malaria and the Global Environment Fund. It is tending, increasingly, to participate in cofinancing activities. Even so, there is no list of all of its activities.

The lack of a clear French strategy with regard to multilateral co-operation also means that there is no really visible link between its bilateral and multilateral activities, apart from joint projects in the field. Generally speaking, France would gain by making use of its bilateral experience in international bodies in a number of areas, as it has done successfully with respect to HIV/AIDS and debt reduction. It could draw on the experience of other DAC members which seek to involve their representatives in the field in preparing their positions in the executive bodies of multilateral institutions.

A marked leaning towards European aid

Multilateral aid under the heading of European aid comprises France's contributions to the EDF and to the general budget of the European Commission earmarked for development activities. It accounted for 64% of France's multilateral ODA in 2002, or 19% of its total ODA[9] (see Table C.2). The fact that France's multilateral aid is made up largely of European aid is due in part to its disproportionately large contribution to the EDF, of which it provides 24.3% of the resources (by comparison with a budgetary share of about 17%). The share of European aid is increasing because of the recent acceleration in EDF disbursements.

France contributed to the debate about making European aid more effective by proposing the budgetisation of the EDF (Bocquet and Viallon, 2003). The suggestion was favourably received by the Commission which proposed to the Council that the EDF be included in the EU budget by 2007; this is now under discussion. It is a measure that would further the efforts to improve aid management. The

8. The average is slightly higher (32% in 2002) if only DAC members which are members of the EU are taken into account.

9. The same averages for EU Member States come to 53% and 17%, respectively. Only Denmark, Ireland, Luxembourg, the Netherlands and Sweden have a European aid share equal to less than 10% of their total ODA.

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biggest advantage would be that the Commission would have a comprehensive picture of its development activities, while EU solidarity with the African-Caribbean-Pacific countries would also be perpetuated.

Contributions to development banks

France's contributions to development banks constitute the second major category of multilateral ODA, with respectively 4% of aggregate ODA in 2002 for the World Bank group and 2% for regional development banks (see Table C.2). The MINEFI prepares an annual report on France's participation in the International Monetary Fund (IMF) and the World Bank (MINEFI, 2002). This report to parliament is published in order to clarify the roles and responsibilities of the two institutions and the positions that France takes within their executive bodies.

United Nations institutions: contributions need to be stepped up

France's contributions to United Nations institutions are the smallest category of its multilateral ODA. The share of aggregate ODA devoted to them (2% in 2002) is below the DAC average (7% in 2002) (see Table C.2). In comparison, France's payments to these institutions are significantly less than those of the United States, Japan and certain EU Member States (Denmark, Germany, Italy, the Netherlands, Sweden and the United Kingdom). Without a more explicit posting of multilateral aid, it is difficult to judge whether these figures reflect a clear policy choice. Nevertheless, the strategic preferences that France seems to want to afford to United Nations institutions - in view of their role in making globalisation more equitable - would not seem to be reflected on a budgetary level. The French authorities admit that they could step up their support, and they plan to allow some latitude in connection with the increase in ODA, although they do not specify how this would feed through in terms of French contributions to the budgets of these organisations.

The breakdown of contributions for 2001-02 (see Figure, Table C.2) shows that 55% of French contributions go to six organisations and funds,[10] whereas 45% is divided amongst a multiplicity of organisations and funds, the breakdown of which is available for less than half of the amounts in question, giving a good indication of the extent to which resources are spread. France might consider a more selective and more sharply focused approach so as to increase its contributions to institutions that support its objectives. Like other DAC members, France could formulate a set of criteria for choosing the organisations with which it intends to maintain special partnerships.

Points for consideration

- Identify how to ensure continued growth in ODA to offset the gradual reduction of debt treatment in the near future.
- Seize the opportunities held out by the LOLF to adopt a transparent and multi-year planning process.
- Review geographical selectivity within the ZSP setting priorities on the basis of the resources needed to achieve the MDGs and the possible impact, in view of the receiving countries' commitment and performance.

10. The World Health Organization (WHO), UNDP, United Nations Organization for Food and Agriculture (FAO), the Office of the United Nations High Commissioner for Refugees (UNHCR), the United Nations Organization (UNO) and the United Nations Children's Fund (UNICEF).

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- In the social and education sectors in particular, bolster the share of funding to support implementation of developing countries' sectoral strategies.
- Make multilateral strategy more explicit, in budgetary terms as well, and capitalise on lessons from bilateral experience in multilateral action.
- Engage in dialogue on the role that NGOs could play in strengthening civil society in the developing countries and consider an increase in co-financing of NGO projects.

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CHAPTER 3

REDUCING POVERTY AND INEQUALITY: THE FRENCH APPROACH, AND ITS APPLICATION IN INDIVIDUAL SECTORS

Reducing poverty and inequality

A comprehensive approach to reducing poverty and inequality (RPI)

The last DAC examination regretted that poverty reduction was not sufficiently reflected in French ODA policies, and that available statistics did not provide enough detail to be able to track accurately the amounts committed to this issue. The French interest in poverty reduction has been confirmed with the government's decision to support the MDGs. An initial assessment of French cooperation (MAE/DGCID, 2000b) recognises that poverty reduction is not an explicit thrust of that cooperation, and that the approach used could result in a dispersal of efforts and a dilution of their effects, because of the lack of explicit choices. Most interventions have helped to reduce poverty, but there have been some perverse effects that have exacerbated inequality and marginalised certain social groups. These effects were difficult to analyse because of the lack of monitoring/evaluation and of specific indicators.

The assessment provoked a good deal of thinking among different interdisciplinary groups, including the Reseau Impact created with MAE support to foster synergies in dealing with the problem of RPI within the French co-operation programme. In a report entitled *Combating Poverty, Inequality and Exclusion: a Contribution to the Debate* (MAE/DGCID, 2001b), MAE recognised that poverty is a social and cultural fact as much as an individual one, and that it has a political as well as an economic dimension, and that all these aspects interact. By introducing the notions of exclusion and inequality, it places the political dimension at the core of development strategies. Rather than attempting systematic targeting, the French approach seeks to integrate poor and marginalised groups within more comprehensive interventions and to diversify solutions for responding to the different needs of the social categories concerned.

There are five basic principles that are supposed to guide French aid policy (MAE/DGCID 2001b): (i) making RPI a priority but not an exclusive focus (in the context of sustainable development); (ii) examining the relationship between growth and poverty by studying redistribution policies; (iii) integrating the notions of exclusion and inequality into the notion of poverty; (iv) recognising the essential role of government and public policies in promoting equity and social cohesion; and (v) establishing a link between RPI and globalisation. In this context, trade regulations that harm the interests of LDCs and government-to-government relations need to be reconsidered.

AFD has repeatedly demonstrated an interest in combating poverty and inequality, as can be seen in the wealth of publications it has produced on this topic. Its *Note on Poverty and Inequality Reduction* (AFD, 2001) recognises that the international objective of poverty reduction is difficult to integrate into sector strategies. The agency proposes focusing its activity in three areas: creating economic opportunities; reinforcing capacities for beneficiary institutions and groups; and helping marginalised groups to reduce their vulnerability to short-term shocks and longer-term ecological

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degradation. It is paradoxical that in the agency's strategic plan the question of RPI, to which it appears fully committed, is explicitly addressed only with respect to health and education, "whereas immediate efforts are needed to extend this concept to all economic sectors, infrastructure, social sectors, support for a professional organisations and social organisations" (Lavigne Delville, 2003).

In a similar vein, questions might be raised about the action of MINEFI in conceptualising and implementing RPI. The importance of debt relief in French ODA inevitably involves this ministry in poverty reduction issues. Questions concerning debt treatment deserve to be an integral part of further thinking about RPI.

Some operating principles

The work done within the Impact Network has produced some principles that constitute a "community of practices" for implementing RPI:

- There should be a "stakeholder focus" designed to upgrade the capacity of social players to make and carry out proposals. This approach goes as far as supporting potential counterweights (for example, farmers' organisations).
- Co-operation is best negotiated with partners, adapted to specific national circumstances, and placed on a contractual basis, as in case of the C2D.
- The state must be reinforced, decentralised and made accountable. Public policies play a key role in the improvement or deterioration of living conditions for disadvantaged groups. Government departments with weak technical capabilities should be strengthened as well as civil society, which must hold the government accountable for the way it treats its citizens.
- Inclusive growth models and systems for redistributing growth should be planned to improve poor people's access to productive resources. Interventions are supposed to benefit all through the "trickle-down effect".
- At the same time, worldwide political arrangements should be pursued in order to control the effects of liberalisation on the planet's poorest people.

Risks and challenges in RPI

While it is intellectually attractive and well founded, the "inclusive approach" of RPI and its corollaries do not resolve the problem of fragmentation that was discussed in the first assessment of French efforts at poverty reduction. Moreover, there is no systematic practice for reconciling the various dimensions (political, economic, sociological, institutional, territorial and sectoral) underlying RPI. As the DAC mission noted in Benin (see Annex E), French cooperation is often scattered among different players and at levels of commitment, and the diversity of objective makes it difficult to achieve synergies. Taking the MDGs as a benchmark, French cooperation in Mauritania (see Annex F) was able to overcome these difficulties to some extent and to retain its focus on poverty reduction.

From the conceptual viewpoint, RPI is fairly close to *The DAC Guidelines on Poverty Reduction* (OECD/DAC, 2001), in particular when it comes to the multidisciplinary approach to poverty, its causes and recurrent factors, certain priority areas of action, and the need to expand dialogue with different partners. The guidelines however go beyond the French approach, in terms of practical recommendations. For example, they call for: taking national poverty reduction strategies and national budgets as the programming framework; defining clearly the roles and responsibilities of different partners; investing in country-led co-ordination mechanisms; pooling some activities (common data collection and analysis, joint missions and evaluations, etc.) more effectively; and simplifying the

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administrative and financial aspects of aid. These recommendations constitute in principle a framework that is supposed to guide French cooperation activities.

Generally speaking, French co-operation should be solidly based on RPI, which would help to clarify geographic and sector choices, operating modalities, and the respective and complementary roles of different players: the MAE, the MINEFI and the AFD, but also the OSIs and the people involved in decentralised cooperation. The accent should be on analysing social stakeholders and their interrelationships, and on developing monitoring instruments. France could make more systematic use of local or regional experts who are fully familiar with the political and socioeconomic complexities of its partner countries, and it could cofinance activities of this kind, particularly in the context of national strategies.

Difficulties in mainstreaming the gender dimension

The MAE and AFD have produced a number of documents in recent years demonstrating that reducing inequalities between men and women is an integral part of combating poverty and inequality: "combating poverty, inequality and exclusion … requires us to reformulate the relationships between men and women, between social groups, among governments and between government and societies. Given these challenges, it must be constantly borne in mind that poverty and inequalities and exclusion require a sustained political commitment over the long term" (MAE/DGCID, 2001b). While the gender dimension has gained ground in French cooperation policy, it does not yet have the importance accorded it by some European and multilateral partners, in particular with respect to the methodological implications inherent in mainstreaming this issue into aid practices.

Aware of the limitations of its gender equality policy, the DGCID commissioned a study on gender mainstreaming in French co-operation activities (Roy and Villeret, 2002). On the basis of an analysis of various categories of projects implemented since the 1995 Beijing Conference of 1995, that study concluded, first, that information on these projects was not consistent enough to make "gender" efforts visible, even within the Department itself. In terms of policies, the report highlights the difficulty of positioning the French approach to gender issues in the absence of a clear strategy. The objective of reducing inequalities between men and women and empowering women is rarely explicit, "even if it is possible that this objective may be partially achieved by actions focused on women's specific needs".

When it comes to projects, the productive role of women is generally overlooked, but some specific activities in traditional sectors (health and education) respond effectively to women's needs. The DAC mission to Benin and Mauritania reported a similar finding. Many interventions are innovative and original, for example in microfinance, in some sensitive areas such as sexual tourism and genital mutilation, and in rural development. Yet there is little or no understanding of the real impact of projects, because there are no evaluations that take into account the gender issue, and gender-specific economic and social data are virtually nonexistent. Moreover, the failure to capitalise on previous progress impedes gender mainstreaming within the DGCID.

The DGCID seems to have shifted into action since the report appeared: an interdisciplinary network of Francophone experts - Gender in Action - was established in 2002 to exchange, co-ordinate and make use of research and expertise in the gender field. The MAE is cofinancing projects with UNICEF, the United Nations Population Fund (UNFPA) and the International Labour Organisation (ILO) on this question. Recently, a strategy paper (MAE, undated) was issued on promoting women's rights and gender equality, proposing: (i) to mobilise expertise from France and the South and strengthen partnerships, especially with the United Nations Development Fund for Women (UNIFEM), in order to participate more actively in international discussions on these issues; (ii) to

reinforce action research and expertise in the South; (iii) to promote systematic integration of gender into sector strategies and into all stages of the development project cycle; and (iv) to implement programmes specifically targeted at women or at combating inequality between men and women, while enlisting men in the effort. The very low level of human resources (less than one person) available to deal with the gender dimension within the DGCID could however seriously jeopardise the successful implementation of this ambitious programme.

An operational memorandum from AFD (2001c) on gender mainstreaming makes it part of the agency's mission to reduce inequalities between men and women. That memorandum calls for incorporating the gender dimension into projects for: (i) basic social services; (ii) local, urban and rural development (access to infrastructure); and (iii) productive and employment-generating projects. For the last two years, the gender dimension has been integrated into the computerised project management system. This tool should allow for progress in mainstreaming gender in the agency's activities. The AFD also contributed to the publication entitled *Water, Gender and Sustainable Development* (Allély, 2002) and to a DAC "tipsheet" on "*Urban Development and Equality between Women and Men: the Case of Market Rehabilitation*" (OECD/DAC, 2002b). Despite these efforts, gender mainstreaming has lost ground in the last two years, because the "gender" position was vacant at the AFD. Since 2003, a single person has been responsible for this function, contributing primarily to project design methodology and providing advice when projects are being considered in the operations committee. It is also unfortunate that the agency's strategic plan (POS) make virtually no reference to gender. It is to be hoped that with the start-up of the pilot study on gender and water (see Box 6) the agency will step up its efforts in this area, and develop a broader programme for the entire institution.

Sector guidelines for RPI

New activities in the health field

Through its activities in the health field, France is seeking to serve the RPI objectives of the international community. It is helping to structure health systems and services through a comprehensive, integrated and decentralised approach in order to ensure better service and accessibility to quality care at all levels of the public health system. It seeks to established linkages between various aspects: policy definition, communicable diseases, national pharmaceutical policies, multisector preventive actions, preparation of legislative frameworks, and research. It has recently started financing mutual health and sickness insurance schemes.

Endemic disease control is a priority target for the DGCID, consistent with the French President's announcement supporting the Global Fund to fight AIDS, Tuberculosis and Malaria. Contributions to that fund have risen sharply, from EUR 17 million in 2000 to EUR 56 million in 2002, and EUR 150 million in 2004. Increasing numbers of aid workers are being assigned to this field (see Box 5). This involves ministries, hospitals, health professionals, NGOs and researchers. France also contributes financially to specialised UN agencies, including WHO, UNAIDS, UNICEF, and UNFPA. Its HIV/AIDS programmes have been especially innovative, thanks to partnerships that have succeeded in enlisting civil society participation and in reaching out to the most vulnerable groups (MAE/DGCID, 2001).

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Apart from its focus on controlling pandemic diseases, the French health strategy operates at several levels at once, which increases the impression of a dispersion of efforts and resources. This factor could be minimised if the geographic and investment choices took better account of poverty and inequality concerns, for example on the basis of a poverty determinants analysis. Another challenge is to bring coherence and operational co-ordination to the components of French health policy that are shaped by governments but implemented by local players in the field.

Box 5. The French commitment to combating HIV/AIDS: an innovative and inclusive approach

The French government's HIV/AIDS programme was launched in 1985 following the first epidemiological surveys among sample populations in Central Africa. Since the Paris Summit of 1994, which was devoted to combating AIDS, France has translated this commitment into a significant increase in budgetary and human resources, concentrated on a limited number of Francophone African countries. An external evaluation of its HIV/AIDS programmes over the decade 1987/97 found that the French government has earmarked an average of EUR 12.2 million to this cause, in addition to its multilateral commitments, of which 62% was for projects and 35% for technical assistance, the remainder being divided between non-project research grants, mission-administered funds for diplomatic posts, and cofinancing of projects supported by French OSIs.

The French HIV/AIDS strategy has been implemented through a growing range of modalities, including information/education, safe blood transfusions, voluntary and anonymous screening, reducing mother-to-child transmission, and providing medications and antiretroviral drugs through the International Fund for Therapeutic Solidarity that the President of the Republic launched in 1997. Finally the ESTHER initiative (*Ensemble pour une solidarité thérapeutique hospitalière en réseau*) has taken the hospital as the basis for co-operation in providing access to treatment. Over time, French co-operation has acquired unique expertise in ensuring complementarity in its interventions and quality in its broad range of technical assistance tools.

AFD has agreed to an initiative to reduce the risk of HIV/AIDS in all projects and programmes that it finances by including specific aspects for combating this pandemic in aid projects. The approach is still sporadic, however, and limited to a few countries.

Source : MAE. International co-operation policy of France in combating HIV/AIDS in developing countries, 2002.

Progress in basic education

France has long focused on university and advanced technical education, the *Francophonie*, and fellowships and internships, with the objective of forming national elites. Since the Millennium Summit it has been strongly committed to the international goal of education for all. Financing in this area has grown from EUR 71 million in 2001 to EUR 116 million in 2002. By comparison with its overall education funding, however, French support for basic education has remained modest (see Chapter 2).

France has shown its determination to act at the multilateral level by reinforcing its contributions under the strategic plan for basic education adopted at the Dakar Summit in 2000, with UNESCO and the World Bank. Within the European Commission's group of experts, it has urged expanded and improved co-operation in this area. It also supports work of the Association for the Development of Education in Africa (ADEA) as well as activities on behalf of the *Francophonie*. It supports the "Pôle de Dakar", a centre of expertise providing region-wide technical assistance for preparing and implementing education strategies. Another priority area of the French strategy is a technical and vocational education programme to help partner countries to prepare training policies, to encourage rotation between work and study, and to create and manage continuous training programmes.

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Since 2000, AFD has been earmarking funds for education infrastructure. Several projects have been undertaken in basic education and advanced technical training, through 10-year education sector programmes.

A highly positive aspect of French co-operation policy is its growing contribution to the efforts of multilateral organisations promoting basic education. France could also review its operating methods in order to: (i) coordinate education projects more closely with the PRSPs and integrate them into sectoral approaches; (ii) strengthen national diagnostic capacities and tools for managing education systems (evaluation and programming); and (iii) ensure better coordination with other donors, particularly multilateral agencies. The programme approach in support of the World Bank's "fast-track initiative" could serve as a model in this regard.

Innovations in the water and sanitation sector

France has undertaken numerous commitments in the water sector since the 2002 World Summit on Sustainable Development and the 2003 World Water Forum in Kyoto, during which the President of the Republic announced a doubling of ODA for this resource, from its current estimated level of EUR 180 million. France has also stressed that the report of the World Panel on Financing Water Infrastructure, chaired by Michel Camdessus, marks an important step in the international community's commitment to achieving the MDGs.

France has been working with its partner countries on framing national water policies and codes, establishing watershed agencies and municipal services, and setting up water users committees for the agriculture sector (MAE/DGCID, undated). It is supporting international organisations such as the *Solidarité Eau* programme (pS-Eau), the International Water Management Institute, and the water and sanitation programme, each of which is working in its own field of expertise to disseminate French know-how and ensure a French presence in international circles. The DGCID has taken the lead in the "Integrated Water Resource Management" portion of the European initiative launched at the Johannesburg Summit, and is providing important support for training in various aspects of water management in Africa. Finally, it is supporting constitution of a European water fund, under the EDF.

Over the last 10 years AFD has devoted more than EUR 1 billion to water supply projects. It has been involved in urban and peri-urban water and sanitation systems, village water supply, irrigation, and hydroelectric development (AFD, n.d.). The agency considers various aspects of sustainable management of water, including local living conditions as well as technical, institutional and environmental aspects. It stresses the durability of services provided as a means of promoting sustainable development. It also finances public and private partners, takes an equity position in mixed companies, and supports the development of partnerships. The agency has contributed in this way to improving water supply in both rural and urban areas, with a constant eye to technical efficiency and reliable service, through the assertion of community ownership and the involvement of the private sector. This is one of the most innovative fields of French cooperation, and one that is growing, thanks to recent funding increases for this sector.

France intends "to support the development of urban services … with clear rules of good governance, defined in a context of comprehensive municipal policies associating private operators, civil society, and local governments". It emphasises "the principles of management established in the 'charter of commitment' for water and sanitation that France presented at Johannesburg (MAE/DGCID, n.d.). As part of their environment and natural resource management activities, AFD and MAE are seeking to adapt multisectoral methods to the management of domestic and international rivers, the economics of irrigation, and watershed management.

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French policy addresses key elements of poverty reduction: water and sanitation, and their impact on health. Promoting participatory approaches is one of its strong points. According to the report on France's poverty reduction effort (MAE/DGCID, 2000b), in this sector "… there is a determination to be realistic, to analyse the complex interplay of stakeholders, which include not only governments and privatised enterprises, but also leading local personalities, politicians, private operators and users committees, without harbouring too many allusions about the representativeness and 'democratic' behaviour of these committees". Gender considerations are not systematically taken into account in these interventions, but efforts in this direction are underway (see Box 6).

Box 6. A method for mainstreaming gender in water sector programmes

AFD is today reaffirming its intention to integrate gender issues at both the strategic and the operational levels. A pilot project on gender and water is designed to develop methodological tools for use in the water sector, based on gender mainstreaming experience with five projects in four African countries (Mali, Mauritania, Kenya and Mozambique). The idea is not to develop a standard "gender recipe" applicable to all water projects, but rather to analyse the diversity of methodological responses in each project, so as to arrive at some practical recommendations.

The gender dimension is particularly relevant in water and sanitation, because the retrieval, storage and use of water falls for the most part to women and girls, and it is they who perform most of the tasks related to sanitation. While the principle of gender mainstreaming is evoking growing interest and acceptance on the part of development partners, there is still some difficulty in putting these good intentions into practice in project themselves. It is to deal with this operational problem that AFD has prepared a pilot study.

The pilot study will take two years. As a first step, a set of practical recommendations will be issued so that some key considerations for implementing the gender initiative can be integrated at the outset into the terms of reference for the tendering process. An overall methodological framework will then be prepared, recalling the objectives, the resources to be mobilised, and the results expected for all five projects. This framework will be presented in the form of a matrix of outcome indicators intended to provide guidance to the consulting engineer and the gender expert on each project, in preparing and implementing a methodology. The gender expert will provide methodological support as needed throughout the project, working closely with the sociologist and the outreach workers.

The process will be permanently monitored by the *Solidarité Eau* (pS-Eau) programme in order to harmonise the approaches of the various experts, to monitor and then to capitalise on the results of gender mainstreaming in the five projects. At the end of the two-year study, pS-Eau will draw up a methodological guide that will be presented as a practical manual for water project practitioners and operators.

Source: Adaptation of "Presentation on the horizontal study for gender mainstreaming in water supply and sanitation projects", prepared for AFD staff, 2002.

Local development, decentralisation, and land use planning: complementary approaches

Local development and decentralisation have long been the subject of academic debate. In fact, these two processes are quite different in nature but are mutually reinforcing. Local development focuses on stakeholders rather than infrastructure, and on networking rather than on established institutions, in order to ensure that individuals and groups with a direct interest will have a say in activities. It is above all "… an economic and social movement, and a cultural one as well, more or less concerted, driven by individual and collective stakeholders in a given locale" (Husson, n.d.). In place of project aid or a programme focus, local development takes an approach that facilitates the establishment of "services" (diagnostic assessment, financial and information tools, etc.). The difficulty with local development is that its management is so complex.

Decentralisation is a strategy decided and organised by governments "… that involves introducing or expanding the powers of public institutions, whose jurisdiction is defined by law". Support for decentralisation is intended above all to strengthen the local authorities and their administration. Decentralisation does not automatically mean democracy at the local level: local leaders can hijack power and "form a screen between people's aspirations and operators from the North". Local development and decentralisation are also distinct from development based on land-use planning. The latter holds that "It is primarily the networks of relationships and the proximity of stakeholders that form the dynamic base for development, and the building of infrastructure will support those dynamics" (Husson, 2001).

French co-operation partners in the public and private sectors and in voluntary organisations are today working in all three fields. The MAE is striving for coherence between the three approaches (top-down, bottom-up, and cross-cutting) through activities at the national, regional and local levels, and its land-use policies (AFD, 2000). For AFD (2001b), the challenge is to reconcile the "demand-driven approach", involving participatory processes, and the "supply-driven approach" inherent in national sector programmes. Thus it gives priority to financing local facilities (water, social services, roads) identified directly by the local people, and equipment for the conservation and management of renewable natural resources. The agency also supports OSI-sponsored productive investment projects. In countries where decentralisation is already in place, such as Benin, local project financing is now the preferred route for strengthening local capacities and mobilising local resources, particularly through the taxation system. The agency's approach is based on "local partnerships", where it works with municipal councils and representatives of civil society living within their jurisdiction. In this effort it looks to other donors, such as the World Bank and the EU, for cofinancing. Local development is mobilising growing numbers of decentralised co-operation partners. To avoid becoming beholden to partisan interests, French organisations need to consider carefully the way in which they work with the local social and political fabric, and to negotiate co-operative approaches in the context of existing national programmes.

AFD conducted an evaluation of a series of local development projects (AFD 2000). In terms of achievements, the involvement of beneficiaries in investment decisions and management has improved people's access to water, health and education, and has strengthened the capacities of local officials and staff. Aspects relating to natural resource management have been thoroughly taken into account and local stakeholders have been prepared for decentralisation in ways that have fostered inter-stakeholder dynamics. However, inadequate attention has been paid to the management and maintenance of works by the management committees, and project monitoring and evaluation has produced few if any elements for assessing the impact on the neediest groups. This is apparent in the outcomes, both in the selection of investments and in the place accorded disadvantaged groups, and women in particular, in the bodies responsible for decision making or the transfer of know-how.

Local development and decentralisation can create spaces for promoting democratic debate. According to the poverty reduction assessment report (MAE/DGCID, 2000b), local development programmes have focused primarily on supporting municipal staff and officials in the management and operation of decentralised institutions. One positive aspect of these projects is that they contribute to an understanding of decentralisation legislation and the rights and duties of the various stakeholders, from government to private citizen. As to decentralisation support programmes, they have not paid sufficient attention to the dimension of "emerging local democracy", and their promoters have given little thought to the risk of reproducing the dysfunctional aspects of central government at the municipal level.

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Points for consideration

- Multidisciplinary thinking about RPI, rich as it is, should incorporate the MDGs more explicitly, as the international frame of reference for combating poverty in the world.
- The French approach leads to the dissipation of efforts at different levels (national, regional, local) and implies a wide range of partnerships and instruments, the coherence and coordination of which needs to be improved. French co-operation should make more use of certain types of analysis (for example, sociological and gender analysis).
- Whether in the AFD or the DGCID, a specific budget could be allocated to promoting gender and gender-focused monitoring and evaluation methods in order to ensure the mainstreaming of this dimension. This would also serve to identify more clearly how much is really devoted to this issue, by programme and by country.
- The link between sector objectives and reducing poverty and inequality could be made more visible through the development of indicators (process, outcome and impact indicators) adapted to the different levels of intervention.

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CHAPTER 4

POLICY COHERENCE FOR DEVELOPMENT

Enhancing policy coherence for development

The OECD and its members recognise that in order to make a lasting impact on poverty in developing countries and to achieve the MDGs, coherent and complementary policies are needed in the economic, social and environmental fields. In adopting the "Action Shared Development Agenda" in 2002, OECD members stressed the need for industrial countries to pay greater attention to the impact of their policies on developing countries. That initiative followed upon earlier commitments within the DAC (OECD/DAC, 1996 and 2001) to make policy coherence for development the common denominator of government policies and to adopt the means to achieve that goal on both the national and international fronts.

Strengthening policy coherence for development implies taking account of the needs and interests of developing countries in the context of the evolving world economy. This is a challenge for industrialised countries, where domestic interest groups and government departments are frequently preoccupied with other concerns and responsibilities than combating world poverty. Moreover, EU Member states must act simultaneously at the national and community level, since the European Commission now has jurisdiction in certain areas of government action (see Box 7). EU member states can use their influence, individually or through strategic alliances, to bring coherence to policies through their participation in various European institutions.

Opportunities and challenges for France in terms of policy coherence

Initiatives to integrate African countries more fully into the world economy

At the Franco-African and the G8 Summits in 2003, the President of the Republic proposed a trade initiative for Africa that would introduce "affirmative action" for the continent. This initiative recognises that trade liberalisation is so far of limited benefit to most African countries. It consists of three elements: (i) a standstill on the agricultural export subsidies that are so destabilising to Africa, for the duration of the WTO negotiations; (ii) strengthening and harmonising existing trade preference systems; and (iii) providing protection against fluctuating commodity prices. On this last point, a number of ideas have been proposed, aimed primarily at the IFIs: a closer linkage between the treatment of debt and the behaviour of commodity markets; targeting of assistance for commodity producers; and introduction of price volatility insurance mechanisms.

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Box 7. Policy coherence within the European Union

Within the European Union, the principle of coherence in development assistance policies is enshrined in article 178 of the 1992 Maastricht Treaty. Institutional mechanisms have subsequently been adapted for this purpose, including the amalgamation, under the code name RELEX, of the various directorates involved in the EU's external relations. An informal network of experts has been created among Member states to promote policy coherence for development.

Because the EU is such a powerful trading bloc, the question of market access is clearly an area in which policy formulation must take account of the consequences for developing countries. The "Everything but Arms" initiative adopted in 2001 was intended to eliminate all EU quotas and tariffs for exports from LDCs (except for weapons, and for bananas, rice and sugar, products that would be subject to transition periods before total liberalisation). Like other developing countries, LDCs still face difficulties in overcoming non-tariff barriers, including rules of origin and sanitary and phytosanitary measures applied to agricultural trade for the protection of human, animal and plant health. These provisions are growing in importance, as other obstacles to trade disappear.

Community policies, such as the Common Agricultural Policy (CAP), designed to preserve the rural way of life in member states, can also have significant repercussions on the prospects of developing countries. The CAP provides for agricultural production subsidies within the EU. Export subsidies are then used to dispose of its farm surpluses on other markets at prices below the cost of production, in this way depressing world prices. There is evidence that subsidised products of this kind give rise to unfair competition on local markets, particularly in developing countries where farming is the main source of livelihood for most of the population. EU Member states and the Commission are pursuing negotiations to reform the CAP in order to reduce the trade distortions it causes. In 2003, the agriculture ministers of EU countries agreed that the majority of subsidies should in future be disconnected from production volume.

In a direct application of this initiative, France submitted proposals to the EU Council of Ministers in late 2003 calling for a European initiative on "cotton and development in Africa". These proposals focus on two complementary aspects: obtaining fairer trade conditions on international cotton markets, and supporting cotton-producing countries. They are also intended to back the initiative of four countries concerned (Benin, Burkina Faso, Mali and Chad) at the WTO. The cotton industry is a vital factor in poverty reduction for these countries, since it involves 2 million farmers and has an impact on 15 million of the poorest people. Although they are efficient producers, they are penalised by the trade distortions caused by subsidies to American and European cotton producers. France has been providing support to this sector for more than 25 years, with an investment of EUR 757 million. The French proposals met a favourable response from the European Commission (2004), which in early 2004 announced a partnership between Africa and the EU in support of cotton development. As a first concrete step, the Commission intends to sponsor an international cotton seminar involving all stakeholders, *i.e.* African producers, EU Member states, and the IFIs.

This shows that an EU Member state can play a constructive role and can influence the decision-making process to take better account of developing countries' interests. In this context, France should be encouraged to pursue the CAP reforms begun in 2003. Those reforms represent an important step in making more room for the play of market mechanisms and reducing distortions in international trade by decoupling support payments from production. France should undertake to limit its use of production-based subsidies, which are still authorised for some products, so as to reduce any distortions. Beyond its cotton initiative, it could also support the European Commission's efforts in other areas not covered by the reform, such as sugar, olive oil, tobacco and hops, and it could move further towards reducing market price support levels, which will remain high even after the CAP reforms, particularly for cereals.

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Since 2002 France has stepped up its efforts to bolster the trading capacities of developing countries, and especially those in Africa. Multilaterally, it provides financial support for WTO technical assistance and for the comprehensive framework for integrating trade into development strategies. Bilaterally, AFD projects often serve to improve export capacity and economic diversification. For the period 2002-05 it has also launched a programme specifically devoted to trade capacity building for a dozen countries in Africa and Asia. This programme, amounting to EUR 30 million, is being implemented jointly by DREE and AFD. It finances technical co-operation and training to help integrate these countries into the multilateral trading system, and to expand their exports. The DGCID is sponsoring complementary projects.

A good example of French support: the Mauritanian fishing sector

Because of the abundance of fish in Mauritania's waters, fisheries are a major sector of activity for this country and one of its main sources of exports. The authorities have understood the risk of over-exploiting fish stocks that is inherent in an industrial approach, and have seen the need to promote small-scale fisheries. According to the United Nations Environment Programme (UNEP) (IMROP, 2002), non-compliance with fishing quotas by certain foreign vessels with fishing rights in Mauritania, plus the lack of monitoring, have led to over-fishing. In 2001, Mauritania and the EU renewed their fisheries agreement for five years. This new agreement increased by 30% the number of cephalopod fishing vessels of EU origin authorised to fish in Mauritanian waters – an increase made possible, according to the European Commission, by the departure of a number of Asian vessels. However, Mauritania's fisheries research centre (*Institut Mauritanien de Recherches Océanographiques et des Pêches*, IMROP) estimates that octopus stocks are over-exploited by 30% in relation to the optimum level.[11] This has led to a 50% decline in octopus catches over a four-year period and job losses for 3 000 Mauritanian fishermen.

French co-operation has supported the development of the fisheries sector ever since it was established in the early 1980s. It has provided support to the sector as a whole (research, training, protection of the marine environment and pollution control, resource conservation and sea surveillance), while giving priority to small-scale fisheries that generate jobs and income. Mauritania could soon benefit from an initiative aimed at promoting quality control of exports and ensuring compliance with European sanitary standards. France's support for fisheries has had an undeniable impact by helping to establish an occupation that did not exist previously, as Mauritanians have traditionally been livestock producers. The various Mauritanian partners in this sector are particularly grateful to the French authorities for having supported capacity building, which enabled Mauritania to be in a strong bargaining position during the negotiations on renewing the fisheries agreement with the EU. Even though the final result would suggest that Mauritania's budgetary interests[12] have prevailed over sustainable development concerns, the decisions were taken on the basis of a better understanding of the situation.

11. According to the Institute's Working Group, which met in 2002 (see Netherlands Institute for Fisheries Research [RIVO] [2003]).

12. Financial compensation for Mauritania amounts to EUR 430 million over five years.

Aware of the Common Fisheries Policy's limitations in ensuring sustainable management of fishery resources, the EU initiated a reform process.[13] A new policy was adopted at the end of 2002 and various implementation measures are being prepared, including those for international fishery agreements. Given its experience in Mauritania, France is well placed to promote policy coherence within this process. As an influential member of the EU, it could more actively promote an approach that would take account of the interests of developing countries and sustainable development considerations when the European Council discusses the Common Fisheries Policy.

Export credits and guarantees: promoting sustainable development

France is one of the most important creditors of developing countries. Given the scope of its debt relief programme and its impact on ODA (see Chapter 2), the French authorities should give further consideration to ways of preventing these countries, in particular the HIPC countries, from falling back into an unsustainable debt cycle. In this context, there is a question as to the attention that is paid to sustainable development considerations by COFACE, the French export credit and guarantee agency, which accounts for a large proportion of developing country debt owed to France.

Internationally, there are a number of initiatives that bear witness to OECD countries' concern to promote coherence between officially supported export credits and environmental protection policies, for which common approaches were adopted at the OECD in 2001, and revised in 2003. The resulting recommendation constitutes a major step forward in protecting the environment while helping to promote fair competition among export credit agencies. It introduces as a benchmark the environmental standards of the World Bank Group and the regional development banks, and seeks to enhance transparency in environmental assessment procedures. The environmental impact is taken to include forced relocation and the effect on indigenous groups and their cultural heritage.

France has reinforced attention to the environment in export credits in accordance with the OECD common approaches. Anticipating the move to minimum standards, COFACE adopted sector guidelines in 2002 for projects involving thermal power stations, large dams, and hydrocarbon development. COFACE publishes ex-post information on its web site on publicly supported export credits exceeding EUR 10 million. Since April 2004, it has also been publishing lists of the most environmentally sensitive projects under consideration: consistent with the OECD recommendation, information from the environmental impact assessment is posted 30 days before a final commitment is given.

At the Johannesburg World Summit on Sustainable Development in 2002, export credit agencies agreed that they had a role to play in promoting governance and sustainable development. At the beginning of 2004, France joined in an initiative with Germany, Denmark and the United Kingdom in the EU Council to have the European Community ask the OECD Group on Export Credits to hold a discussion on allowing additional flexibility for export credits in the areas of renewable energy, water treatment, and waste management. Given the importance of sustainable development in all French government activities, this is a positive move.

France has also undertaken to respect the principles in the 2001 OECD declaration whereby officially supported export credits and guarantees are not to be used for unproductive purposes in HIPCs. The number of projects in HIPCs is limited to one or two a year, according to French notifications to the OECD Secretariat. The Directorate for External Economic Relations (DREE), together with the Treasury, the Budget and the Directorate General for Industry, Technology

13. For more information on the Common Fisheries Policy, see Development Co-operation Review of the European Community (OECD/DAC, 2002a).

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Information and Post of MINEFI, and the Directorate of Economic Affairs of the MAE are members of the interministerial committee on guarantees. The French authorities take into account the contribution of projects reviewed within this committee to sustainable development in beneficiary countries and their impact on debt burden. The MAE ensures co-ordination with its various directorates concerned, particularly the DGCID. The AFD is also regularly kept informed and consulted on projects in its fields of expertise.

Strengthening policy coherence within the French system

As indicated in the examples presented above, the constraints and difficulties encountered point to the need for DAC members to address this question. *The DAC Guidelines on Poverty Reduction* provide some indicators on this point. A key element is a commitment by the political authorities to ensuring coherence among policies that have an impact on economic prospects and poverty reduction in developing countries. The guidelines also call for developing a government-wide policy brief on poverty reduction, establishing cross-ministerial consultation mechanisms, systematically vetting legislation for consistency with policy reduction objectives, and allocating the necessary means for analysing problems of policy coherence.

A strong political commitment

France's commitment to policy coherence for development manifests itself in many ways. Promoting globalisation with a democratic and human face is a key concern of French political leaders. They have on many occasions committed themselves to integrating poor countries more thoroughly into the world economy. The President of the Republic has shown a strong determination to address a wide range of development challenges. Some of his initiatives bear directly on policy coherence, such as the trade initiative for Africa. When it comes to combating HIV/AIDS, France has played a leading role internationally in providing poor countries with antiretroviral drugs at affordable prices. Within the WTO, France has supported efforts to adapt the Agreement on Trade-Related Aspects of Intellectual Property Rights to this goal.

These initiatives testify to France's awareness that the impact of aid depends in part on industrialised countries' policies in the areas of trade, investment and environment. These policies must serve to reinforce development co-operation efforts. Yet despite its strong political commitment to help poor countries cope with the challenges of globalisation, France has not explicitly and publicly declared policy coherence for development to be a government objective. The driving force behind achieving policy coherence for development seems to come primarily from presidential initiatives. Experience in other countries suggests that this thrust could be reinforced and made more durable if the ministers and the experts responsible for the major issues involved in this area could be rallied behind it.

Bolstering interministerial co-ordination

Policy coherence involves subjects of a global nature that should be dealt with through an interministerial mechanism. France has yet to develop a concrete approach for systematically mobilising efforts at the different levels of government in order to assure policy coherence for development. The role that CICID might play in this regard within the French government decision-making process, particularly in terms of trade-offs, is not clear, and its role in promoting strategic thinking about the issue could be reinforced. When it comes to European affairs, the existence of the Interministerial Committee for European Economic Co-operation (SGCI) is clearly an asset. It is this body that is responsible for co-ordinating French positions on European issues, under the authority of the Prime Minister. It is thus the guardian of coherence and unity in the positions that France expresses

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within the EU. It also oversees the application of Community law in France, and could play a key role in terms of arbitrating issues relating to policy coherence if it were given that mandate, together with the resources to exercise it.

As some ministry representatives see it, the fact that development policy relies on two pillars is an advantage. The MINEFI and the MAE embrace various and often cross-cutting functions and responsibilities that give them considerable clout within government. Strengthening the management of global affairs is one of the issues that the MAE is considering in its modernisation process (see Chapter 5). The question is also addressed in the working group on European and international policy organisation instituted at the request of the Prime Minister (*Commissariat général du plan*, 2002). Part of AFD's mandate is to reconcile a local approach to development that allows for public input, and a global approach that is consistent with macroeconomic and sectoral policies as well as major world issues.[14] In the absence of a single agency responsible for development, it is difficult to determine which institution is best placed to play the role of development advocate.

Mobilising expertise

If the debate over policy coherence is to be taken further, it will be important to strengthen the analytical capacities for determining the impact that government actions have on reducing poverty, and to ensure that developing country interests are taken into account more thoroughly. Experience in other DAC members shows the utility of having a specialised unit for analysing measures outside the field of development aid policy and bringing its conclusions to the attention of the responsible bodies within government. The decision to upgrade the role of the AFD to the strategic level could be a first step in this direction. Strengthening the MAE's strategic capacity with respect to global issues could be another step. France's cotton initiatives and its wealth of experience in various fields of co-operation, including fisheries, demonstrate the analytical capacity and resources available at different levels of the administration. The weakness of the French system lies perhaps in the lack of internal organisation for capitalising on all this experience. On this point, the creation of the working group on agriculture, under the aegis of the DGCID, is a step in the right direction. The role of this group, which brings together experts and practitioners from other ministries and from outside government, is to establish linkages between development and trade, and also with the CAP.

It might be useful to institute a broader consultation process beyond the administration. If necessary, the government could mobilise some of the expertise available in the research community by means of a network, as has been done in the campaign against poverty and inequality (see Chapter 3). Strengthening the policy coherence for development could also be enhanced by parliamentary debate of issues involving vital interests such as agriculture. There are several parliamentary committees with an interest in development and globalisation issues, and they could sponsor a useful dialogue with other parliamentary committees. In this context, the Globalisation Observatory created in 2003 at the request of the Prime Minister is a promising initiative. Its mission is to deepen the understanding of globalisation on the basis of available research and to prepare policy recommendations.

14. See *lettre des tutelles* (policy guidance letter) to the AFD Director General, 2001.

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Points for consideration

- Make policy coherence for development an explicit objective of the French government and specify the appropriate institutional arrangements, in particular co-ordination and trade-off mechanisms.
- Give greater consideration to ways of taking developing country interests more systematically into account in French policies, and identify concrete objectives relating to selected issues, for monitoring within ministries and throughout government.
- Mobilise the expertise and analytical capacities available within the administration, and consider creating a co-ordination unit, for example within the CICID, with specific responsibilities for policy coherence.

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CHAPTER 5

ORGANISATION, PERSONNEL, AND MANAGEMENT SYSTEMS

Overview

The 1998 reforms sought to rebalance responsibilities for aid by establishing two pillars, the MAE and the MINEFI which, together with the State Secretariat for Overseas Territories, would jointly oversee the AFD. The French co-operation system, which involves a dozen ministries and a whole series of public agencies,[15] is still complex. In contrast to other members of the DAC, no one institution has the responsibility for co-ordinating the entire system: this is left to the CICID. The MAE and the MINEFI exercise joint functions of policy setting, management and control over French ODA implementation.

Primary responsibility for foreign policy and international co-operation, which is an integral component of that policy, lies with the Minister of Foreign Affairs. He is assisted by two ministers of state, one of them responsible for co-operation and the *Francophonie*, and the other for European affairs. Despite his title, the Minister of State for co-operation, development and the *Francophonie* oversees only the co-operation activities that fall under the MAE.[16] The Minister of Economy, Finance and Industry is also an important player. Among all these political players it is not easy to identify just who has the primary role in aid matters. On the other hand, as noted earlier, the President takes a lively interest in development questions and it is he who undertook to revive ODA, as a political priority.

Parliament has relatively little influence on the direction of development co-operation policy. Despite repeated requests, there is as yet no annual general debate on the matter. Parliamentary consideration is in effect confined to the annual discussion of the budget within the finance and the foreign affairs committees of the National Assembly and the Senate. Under the French constitution, parliament's budgetary oversight role is limited: it cannot call for an increase in spending or for a cutback in revenues; once the budget is voted, the government has the right to amend it. Moreover, given the budgetary classifications currently in use (see Chapter 2), parliament is asked to approve less than half of the spending that constitutes ODA. Finally, the debate covers only 6% of the general budget, since most appropriations are carried forward from one year to the next automatically.

15. For example, the MAE relies on a great number of operators to implement its cultural and scientific relations policy: TV5, RFI, AEFE and many other associations involved in the *Francophonie*.

16. The new title of Minister of State (*Ministre délégué*) for Co-operation and the *Francophonie* was introduced with the change of government in March 2004. This is a positive change, and heralds greater visibility for development within MAE activities.

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The main players in the system

The two main players in the system, the MAE and the MINEFI, are responsible respectively for 29% and 40% of ODA (see Table 1, Chapter 2). The intention to give AFD the pivotal role in French ODA has not fully materialised, because the portion of total ODA managed by the agency is only about 10%.[17]

The Ministry of Foreign Affairs

(i) Structures and responsibilities

Within the MAE, the DGCID has a key role in international co-operation. This is a complex entity, since it has both a political and an operational role, and a worldwide mandate. Its mission is, on one hand, to help guide all the international co-operation activities of government and, on the other hand, to manage four programmes directly: (i) aid for development or transition, implying transfers of know-how (in education, health, economic administration, justice, police, public administration and environment); (ii) cultural co-operation and promotion of the French language; (iii) university exchanges; and (iv) exchanges in the communications sector (press, audiovisual, and new information technologies). It has four operating directorates, including the directorate for development and technical co-operation, and each of them engages in worldwide activities in its own field (see organisation Chart D.1 in the Annex). The DGCID's dual mandate is reflected in the distribution of the budget by sector of activity. While two-thirds of its budget is devoted to ODA-eligible activities, less than one-third goes to activities that contribute directly to poverty reduction (see Chapter 2).

The DGCID's field of action, broad as it is, does not cover all the development activities that come under the responsibility of the MAE. Other departments of the ministry are also involved in development assistance: the United Nations and International Organisations Directorate, which manages contributions to UN funds; the European Co-operation Directorate, responsible for contributions to the EDF; and the humanitarian aid liaison office. As for the *Francophonie*, its office in the MAE monitors multilateral programmes, while the DGCID handles bilateral affairs through its Cultural Co-operation and French Language Directorate and its External Audiovisual and Communication Techniques Directorate.

(ii) Reform efforts

In 2002 the MAE initiated a wide-ranging reform programme. A steering committee was established to spark creative thinking and to consult all staff of the ministry. The "Foreign Affairs 2007" action plan that resulted from the process is designed to give the MAE "a strong and dynamic policy for France's actions in Europe and to promote international solidarity". The plan seeks to reaffirm the ministry's interministerial role by strengthening its strategic capacity and consolidating the budget for the government's external activities. It calls for modernising the ministry's methods and tools by introducing management by objectives, based on monitoring activities and evaluating outcomes. To restore a true policy orientation to French diplomacy is a worthy objective, if it allows the various tools to be co-ordinated and made consistent with preestablished priorities. The concern for efficiency and effectiveness that underlies this exercise demonstrates a clear determination to introduce a culture of results within the MAE, and is in keeping with the spirit of the LOLF.

17. AFD has four sources of funds: grants from the MAE budget; market loans with interest subsidised by the Treasury; Treasury loans; and market loans without government guarantee. In addition, the agency may be mandated by the government to handle specific activities such as the FFEM or the C2D.

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A number of proposals are worth mentioning here because they are relevant to ODA. They include: (i) to consolidate interministerial co-ordination on international co-operation issues, thereby moving away from the notion of "stand-alone channels"; (ii) to clarify the relationship between the MAE and the AFD; (iii) to reinforce decentralisation and the role of the ambassador; (iv) to consider the future of all instruments in a revamped ODA programme; and (v) to take advantage of accumulated development expertise (which today is scattered through the DGCID, the AFD, the universities and research institutes), through networking and building closer links to the research world.

The action plan adopted for implementing these proposals is not sufficiently detailed, however, for assessing the scope and the timing of the planned reforms. There will have to be some major shifts in mentality. The widespread strike that hit the MAE at the end of 2003, and the delays experienced in implementing the LOLF show just how much distance is yet to be covered.

The Ministry of Economy, Finance and Industry

With the MINEFI, ODA responsibility lies primarily with the Treasury, which has a division responsible for debt, development and emerging markets (see Organisation Chart D.2 in the Annex). Its functions relate especially to the following areas: (i) monitoring all issues relating to international debt, including the Paris Club; (ii) international monetary co-operation with countries of the franc zone; (iii) export credit insurance and financing policy; (iv) economic and financial relations with developing countries and transition countries; and (v) relations with IFIs.

The DREE also has ODA responsibilities with respect to project aid to emerging economies. It has at its disposal two instruments, one for concessional loans (the RPE, "emerging country funds") and one for grants (FASEP-*Etudes*). These instruments are often involved in the financing programmes of multilateral agencies.

By comparison with other DAC members, the MINEFI's prerogatives go well beyond the conventional domain of a finance ministry. As a cornerstone of the French co-operation system, it is responsible, together with the MAE, for the political and strategic management of development co-operation. The Treasury Directorate shares the co-secretariat of the CICID with the DGCID. The MINEFI is also a member of the AFD Supervisory Board, as is the MAE. Internationally, this ministry represents France on the executive boards of the IMF, the World Bank and the regional banks, and in the DAC. Despite the scope of its ODA responsibilities, it does not seem to be sufficiently involved in the work now underway at various levels of the French system on ways of reducing poverty and inequality.

The French Agency for Development

During 2001 there was an in-depth examination of AFD's aid delivery and planning approaches, assessing them against the objectives set for the agency by its oversight ministries. The "letter of mission" addressed that year to the new director general asked him to ensure that AFD "does its share to support government efforts to make French aid more effective and more legitimate". AFD thereupon launched a reorganisation that led to the preparation of a strategic plan (POS) covering the period 2002-06. That plan was approved by the Supervisory Board in 2002, and its implementation is tracked on the basis of annual business plans.

The POS is designed "to make AFD a model development agency serving countries of the South and the international interests of France", and it commits the agency to work more actively to renew French co-operation and to engage in international discussion on aid issues. The DOM-TOM, which

account for nearly half of the agency's activities, occupy an important place within the POS. One of its main innovations, in fact, has been to introduce selectivity for countries and sectors. The distinction as to the type of co-operation (broad, targeted, or occasional) should tend to narrow the sectoral spread of programmes in each beneficiary country. However, neither the annual business plan nor the annual report of the AFD presents the list resulting from this process. The range of intervention sectors remains wide despite these refocusing efforts (see Chapter 6).

Another innovation has to do with achieving greater efficiency and cost reduction. AFD is striving to enhance the leverage effect of budgetary funds on total ODA. This should logically lead to more use of co-financing mechanisms and joint undertakings with other donors, under sectoral programmes. The agency intends to make more use of public-private partnerships as a way of mobilising savings, responding to investment needs, and ensuring efficient management. It also aims to increase the average amount of each commitment, so that it can devote more resources to the preparation and monitoring of operations and improving their quality.

The POS has also sparked a review of AFD's financial relationship with government. The agency now has more flexibility to set conditions on its products in order to match financing and project profiles more closely. The already ample range of its financial products has been further broadened and now includes virtually every possible financial instrument, ranging from grants to market-rate loans, and including lending at varying degrees of concessionality, sovereign or not, bond purchases, equity participation, and financial guarantees in local currency.

In practical terms, the POS entailed an internal reorganisation within the AFD in 2002. The agency now has two operations divisions, one for foreign governments (*i.e.* developing countries), and the other for the DOM-TOM (see Organisation Chart D.3, in the Annex). The technical services, which were formerly integrated into each geographic department, have been reorganised into four separate departments: (i) rural development, environment and natural resources; (ii) regional planning and urban development; (iii) human development; and (iv) the financial sector, structured financing, and private sector support. A strategy division has been created, absorbing the strategic planning secretariat, the evaluations and capitalisation mission, the general policy department, the communication, research and knowledge management services, and the secretariat for the French Global Environment Fund (FFEM) and the Centre for Economic, Financial and Banking Studies (CEFEB), the AFD group's training branch.

In its first year of operation, the POS has achieved its objectives in terms of speeding up the pace of disbursements, increasing average project size, and leveraging ODA more effectively (AFD, 2002b). The planning directorate is beginning to show results, in terms of AFD's growing role in interministerial preparations for major international events and the sponsoring of workshops on various aspects of poverty reduction. Yet AFD still needs to strike a proper balance between its role as a "banker" and that of a development project execution agency.

Human resources: staffing according to needs

It is not easy to analyse the human resources devoted to development co-operation within the French system, because this is not the exclusive function of any of the principal institutions. The DGCID has a staff of 559 at headquarters, 436 of whom are assigned to ODA activities. The Co-operation and Cultural Action Service (SCAC) is responsible for field postings and now has some 300 staff working abroad in countries of the ZSP. The DAC field visits to Benin and Mauritania suggest that the MAE does not hire local management personnel. Implementation of the LOLF should lead to a redeployment of overseas staff and allow for local recruitment, including managers, especially for what are regarded as the less sensitive tasks.

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Since it is difficult to distinguish which MINEFI activities relate strictly to ODA, it is not possible to draw any conclusion in terms of staffing levels. It may be noted, however, that the Treasury department responsible for European and international affairs has some 50 officers. To these may be added a dozen people in the DREE who handle the RPE and the FASEP activities. In 2002, the MINEFI reorganised its external services, placing the DREE's economic development positions and the Treasury's financial officers within a single network, the "economic sections" (*missions économiques*).

The AFD has a staff complement of 1 249 employees, 701 at headquarters and 548 overseas (including 126 expatriates and 422 local employees). If persons working for PROPARCO (its private sector affiliate), those on secondment, and those working for the DOM-TOM at headquarters and in the field are excluded, the staff assigned to ODA management amounts to 1 006. The agency has a network of 42 field offices, of which eight are in the DOM-TOM. Nearly half of its staff members are employed in this network, and three-quarters of them are recruited locally for various job categories.

Further thought should be given to the human resource implications of the transformation under way within the MAE and the AFD, and the implementation of the LOLF. In 2003 the MAE set up an "Observatory of professions and skills" that was supposed to offer a dynamic forward-planning tool for human resources in terms of recruitment levels, training needs, performance appraisal, and career management. In the wake of that reform, there remains a question of the means at the disposal of DGCID for maintaining the expertise that was inherited from the old Co-operation Ministry but that could be dissipated over time (Senate, 2001). Moreover, the MAE's operating methods, designed to meet the needs of managing diplomatic officers, are not necessarily suitable or flexible enough to analyse the kinds of expertise needed for development work. When it comes to the AFD, the POS classifies the agency's professional categories into four groups that are to be created/developed, reinforced, reduced/eliminated or redeployed, and it has led to the creation of new functions that require specific skills. The 100 or so recruits taken on in the last two years have brought with them new skills in various professional areas. The staffing structure, while it is still largely dominated by technical categories, is thus changing.

Questions remain as to the deployment of staff in the field. Stepped-up dialogue and co-ordination with partners in the context of the PRSPs and the new programming and sector approaches poses the need for knowledge and skills different from those required in conventional project management. Changes are apparent in technical assistance activities (see Chapter 6). The DGCID and the AFD are assessing the implications of this trend in terms of adapting their own skills base, and the degree of authority that should be delegated to their field representatives. The French authorities have launched a dissemination and training campaign on the concepts emerging from the international development agenda and on the new management-by-results approaches flowing from the LOLF. Training sessions on harmonisation and new aid techniques were conducted in 2003. The CEFEB will offer a new cycle of "co-operation and development" training starting in 2004. These courses are open to all professional staff in France's various development assistance organisations.

Co-ordination

Improvements in interministerial co-ordination

In principle, the CICID meets once a year, chaired by the Prime Minister. It includes all ministers with international co-operation responsibilities, as well as a representative of the President of the Republic. The MAE and the MINEFI jointly provide secretarial services for the committee, although they have not assigned any full-time staff to this task. That may explain the CICID's lack of systematic follow-up of some of these commitments. While the committee does not meet very often (its last

meeting was in December 2002), it has helped to create a climate of interministerial co-operation, both formal and informal. In fact, a good deal of co-ordination takes place in advance of its meetings, which means that the Committee itself meets only to validate the results. Moreover, working groups have been established to deal with specific questions such as procedural evaluation or harmonisation.

Apart from the CICID, there are a number of co-ordination mechanisms that are more operational in nature:

- The strategic guidance committee of the FSP, and its project committee, both of which facilitate interministerial policy management.
- The AFD Supervisory Board, which includes representatives of the MINEFI, the MAE, and the State Secretariat for Overseas Territories, parliamentarians, persons appointed for their economic and financial expertise, and AFD staff representatives.
- The MAE/MINEFI joint *missions* which, with AFD technical support, identify targets for allocating structural adjustment programmes and C2D programming, the steering committee for which also involves close collaboration between the three institutions.

Generally speaking, while there have been noticeable improvements in the level of interministerial co-ordination, the dispersal of activities among several institutions is costly in terms of coherence, visibility, and efficiency. The time spent in working out their respective areas of responsibility detracts from the effort that can be put into defining and implementing policies. The pattern can lead to a duplication of the expertise that has to be mobilised at headquarters and in the field. Under the MAE reform programme, the DGCID is to consider ways of enhancing the efficiency of its work, particularly on strategy. The relationship of DGCID with the AFD stands at the heart of the debate about how to make their complementarity a factor for synergy rather than for competition. This should induce the DGCID to rethink the balance between its policy and operational roles (Réseau Impact, 2003). As well, there is room to improve the correlation between bilateral and multilateral aid (see Chapter 2), something that presupposes closer co-operation between the MAE and the MINEFI.

Much remains to be done to improve synergy between co-operation activities and the research work of bodies such as IRD and CIRAD, the budgets of which include an ODA portion. Although these agencies have a strong presence in developing countries, they tend to work in isolation, and the wealth and variety of their activities is not always sufficiently appreciated and exploited. The DAC mission to Benin found some interesting examples of collaboration between the research agencies, the SCAC and the AFD, most notably in the cotton sector. The political determination to create networks, which are now being instituted at various levels, is one approach that should prove useful.

Standardising co-ordination with non-governmental partners

In addition to the HCCI (see Chapter 1), co-ordination with civil society organisations is handled through a number of other bodies. Within the DGCID, it is the Non-governmental Co-operation Section that is responsible for relations with civil society partners and with the subnational levels of government in France. The AFD also has a co-ordination structure, the "*Club des OSI*". Dialogue with civil society organisations is institutionalised in the form of a joint consultative body, the Development Co-operation Commission, chaired by the Minister of State for Co-operation and the *Francophonie*: it includes representatives of civil society organisations and the ministries with international co-operation responsibilities. When it comes to decentralised co-operation, there is a similar body, the National Commission for Decentralised Co-operation. These two bodies concern themselves primarily with operational aspects of cofinancing mechanisms. The DREE has established a co-ordination structure on international trade issues.

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Generally speaking, dialogue with non-governmental partners has intensified. In the field, the DAC mission to Benin and Mauritania found that co-ordination with NGOs and decentralised co-operation partners was not institutionalised, but that there were several initiatives in the context of preparing for the joint commission meetings (see Chapter 6). The direction that French co-operation intends to take in this regard deserves to be clarified.

Managing information and building on results

There is still limited information and communication about French co-operation, and this does not seem to be a priority aspect for the French authorities. There is no strategy in this area, and few resources have been devoted to it. France's development effort deserves to be promoted, in order to maintain the support of public opinion. As noted earlier, the lack of communication and the cumbersome and murky budgetary process do little to create public visibility. Although the DGCID and the AFD produce an annual report covering all their activities (and not only those of the AFD), and the MINEFI produces a report on the IFIs, these give only a partial and fragmentary picture of France's overall development assistance effort.

Strengthening knowledge management should be another priority of the French system, which suffers from too much compartmentalisation of its components and instruments. The creation of interministerial working groups and the networking of hitherto frequently isolated intellectual and operating resources are interesting initiatives. Recent efforts to provide greater feedback in terms of lessons learned from evaluation and follow-up activities (see section on "monitoring and evaluation" below) also reflect the concern to reinforce knowledge management and to adopt sound practices in this area.

Performance measuring

Monitoring and evaluation: towards a new culture

The culture of evaluation has progressed within the French system since the last DAC Peer Review. The French authorities, who tended to regard evaluation as an instrument for monitoring and refining operational activities, are now looking at it as a learning tool. The interministerial working group on evaluation, established under the CICID, has the mandate to strengthen collaboration between the various evaluation offices in the French system, and to promote a common methodology. Some joint evaluations have been conducted, including several country evaluations and one dealing with administrative co-operation.

Every institution (MAE, MINEFI and AFD) retains its own evaluation structure that works closely with operational departments and decision-making centres. The evaluation units prepare their annual programmes on the basis of proposals from the operating departments, bearing in mind the strategic priorities of their organisation and selecting projects that might offer pointers for policy changes. The evaluations themselves are conducted by consultants, under the supervision of a case-specific steering committee. The AFD, where evaluations were performed by its own staff until 2002, can now draw upon external expertise. The fact that each evaluation unit is accountable directly to its organisation's top management goes some way to ensuring its independence. That independence could be reinforced if the units had greater autonomy in programming their evaluations and formulating recommendations.

The scope of evaluation has been broadened. The evaluation unit of the MAE conducts assessments by country, by sector, and by instrument. The MINEFI plans to evaluate some of the multilateral development funds, in preparation for their replenishment negotiations. In 2003, the AFD

increased the proportion of projects evaluated to one in four. A methodology is now being prepared for conducting horizontal, sectoral and regional evaluations. The annual evaluations budget is EUR 700 000 for the MAE, EUR 500 000 for the MINEFI, and EUR 700 000 for the AFD. These institutions have evaluation teams of seven, three and 12 persons, respectively.

For each of their evaluations, the three units work with a steering committee that organises feedback sessions. Results are disseminated through an annual summary report to the MAE. The AFD itself publishes a biennial report, and once a year the Supervisory Board devotes a session to evaluation. France attaches great importance to the principle of partnership and has made efforts to involve beneficiaries more closely in evaluation work. The local authorities join the steering committees for the country evaluations. The AFD holds feedback seminars to which partners are invited. Finally, the MINEFI organised an international workshop in 2003, in co-operation with the DAC's Network on Development Evaluation, on the topic "Partners in Development Evaluation: Learning and Accountability". In a similar vein, the MAE supports the "Fund for the Promotion of Prior Studies, Horizontal Studies, and Evaluations" (the F3E). This is an association created in 1994 to cofinance studies and evaluations for strengthening the practical and professional skills of NGOs and local governments.

While feedback as such is now well organised, measures have also been taken to ensure that the lessons learned from evaluation are more widely appreciated and that they are turned into recommendations for input to strategic thinking and decision-making. In the MAE, the evaluation unit is a member of the operations committee. FSP projects are all subjected to an internal evaluation, the results of which are sent to the evaluation office. Establishment of a database will give the entire ministry access to evaluation results, using keywords. The AFD has an evaluations committee that reviews the evaluation reports and validates the recommendations. The evaluation and follow-up section now participates in the operations committee, where it facilitates impact analysis by providing monitoring indicators from the project approval stage onwards. All AFD projects have monitoring and completion reports that are fed into a database managed by the evaluation and follow-up section.

There is room for further progress when it comes to the external dissemination of the evaluation reports, which varies from one institution to the next. The MAE makes a general practice of publishing its evaluation reports, except for certain country evaluations. On the other hand, evaluation reports of the MINEFI are distributed only within the administration. Those of the AFD are not publicly available, except with the agreement of the beneficiary. Now that sectoral evaluations are becoming the rule, there are fewer direct references to individual projects, and this should allow the evaluation reports to be distributed more widely.

France is looking for ways to build impact analysis into its evaluations. Currently, most evaluations suffer from a lack of upstream data needed to measure outcomes. Success in this regard will require a more results-oriented approach to programming and implementation. On this point, the DSPs (see Chapter 6) and the sector strategies should make mention of the expected results and identify performance indicators, which should include the MDGs.

Results-based management: initiatives are underway

Aid effectiveness, which France has made a priority, implies results-based management of aid. Implementation of the LOLF by 2006 represents an undeniable step forward, since it will move the entire administration from "management by means" to "management by objectives", and those objectives will be set in advance and measured by outcome indicators. The MAE and the MINEFI will have to prepare indicative budgets using the new format, as of 2004.

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Within the French aid system, the AFD has undoubtedly made the greatest progress in implementing a system of results-based management. In 2002 it established, on an experimental basis, a quality monitoring device for projects in execution. It has also developed a strategic information system that includes indicators of effectiveness, quality, and operational results by country, sector, and financial product, as input to the planning and decision-making process.

With the introduction of the POS, the AFD now prepares an annual business plan that makes it possible to identify results against objectives for the past year, and to present the principal objectives for the coming year. Within the agency, each division and department has a contract of objectives that are stated in terms of volume, quality and organisation. An internal working group was set up at the end of 2003 to introduce a results-based approach to AFD's sector and regional strategies. Its mandate is to establish a link between the objectives in the business plan and development goals, which are expressed in terms of outcomes, by sector and by country, with special reference to the MDGs. Given the effort implied in this initiative, the AFD plans to focus on countries in which it has a sufficient volume of activities. With the introduction of results-based management, it is even more important for the AFD and the rest of the French system to adopt strict geographic selectivity.

Points for consideration

- Upgrade the strategic role of the DGCID, as part of MAE modernisation, and have it delegate ODA delivery to a greater extent.
- Compare the advantages and drawbacks of retaining multiple delivery structures, both at headquarters and in partner countries, in terms of efficiency and transaction costs.
- Strengthen the CICID's capacity for strategic guidance and monitoring of ODA, which could imply more frequent meetings and a stronger secretariat.
- Encourage initiatives to secure greater interministerial internalisation of experience and of lessons learned, including those relating to the evaluation process itself.
- Seize the opportunities presented by the LOLF to establish results-based management against explicit objectives and priorities, available resources, and measurement indicators.

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CHAPTER 6

FRENCH CO-OPERATION IN THE FIELD

Programming and partnership

The country strategy document: a new programming tool

The country strategy documents (DSP) provide a medium-term frame of reference for all official French co-operation activities in beneficiary countries. They are supposed to be prepared every three years, under the responsibility of the ambassador, and to involve all public and private players in France's international co-operation (AFD, businesses, foreign trade counsellors, French partnership committees, OSIs, and representatives of decentralised co-operation) and potentially the representatives of the multilateral institutions to which France contributes (MAE/DGCID, 2001a). The DSPs are initially sent to MAE head office for review before being submitted for interministerial validation by the CICID. To date, 14 DSPs has been validated and 24 are in preparation. These are essentially internal documents of the French administration, and they reflect a "programming by instrument" approach, reflecting the CICID's decision (1999) to exclude country-budget programming "in order to avoid the notion of entitlement". This could change with introduction of the LOLF, which allows for the creation of country budget envelopes.

The DAC missions to Benin and Mauritania (see Annexes E and F) found that there was no systematic consultation on the DSP either with French development partners or between the embassy and the representatives of bilateral and multilateral agencies. This limits the opportunities for co-ordination between French co-operation and that of other donors. In the spirit of partnership that the CICID has called for, the DSP could constitute a point of departure for dialogue with partner countries, in the context of their national programmes (including their PRSPs). The evidence shows that donor countries are beginning to make more use of the PRSPs as a basis for programming, and their strategy documents are now highlighting their contribution to PRSP implementation. With a view to making aid more predictable, the DSP could establish country budget envelopes and could lead to the negotiation of multiyear contracts consistent with the beneficiary country's programming cycle. The responsibilities and obligations of each party, and the delivery mechanisms to be used, could be defined in this framework. Finally, the DSP could include results indicators that take into account the MDGs.

Adapting the joint commission to PRSP realities

One formal mechanism that French co-operation has been using in its programming for several years is the joint commission, through which the French authorities and those of the beneficiary country meet, in principle, every three years. In fact, commission meetings seem to have been held at much greater intervals (seven years between the last two commissions for Benin, and five years for Mauritania). In Mauritania, preparations for the next joint commission will involve government

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officials, OSIs and other donors, but only MAE personnel and a few representatives of the Mauritanian Ministry of Foreign Affairs will attend the 2004 meeting in Paris.

Many observers have expressed the opinion that the very principle of the joint commission is outdated from a co-operation viewpoint, now that the PRSPs are in place, even if they may still be useful for the conduct of overall bilateral relations. The PRSP provides an opportunity for more dynamic and transparent dialogue, with its annual monitoring exercise that brings together all partners in the country. While the principle of the joint commission should be retained, it would be useful to blend it with the PRSP monitoring process. This possibility seems to be recognised by French government representatives both in Benin and in Mauritania.

Delivery mechanisms

Maintaining project aid

France has retained an important role in project aid in places where this form of assistance seems best adapted to local conditions. Project aid is delivered by the MAE, through the FSP, by the MINEFI through the Emerging Country Reserve, and by the AFD. The 1998 reform led to greater specialisation of these different instruments.

(i) The Fonds de solidarité prioritaire

The FSP provides grant funding for development projects in the institutional, social, cultural and research fields in countries of the ZSP. In 2002, 91 FSP projects were approved for a total of EUR 159 million, and currently the portfolio comprises a total of 528 projects.

FSP grants cover three types of projects: (i) country projects (61% of the FSP envelope in 2002); (ii) intergovernmental projects that involve several countries under the umbrella of an intergovernmental body (about 2% of FSP in 2002); and (iii) general-interest projects (*mobilisateurs*) that do not involve a specific government but are rather pilot operations in various fields - *Francophonie*, sector policies and HIV/AIDS (accounting for 37% of FSP in 2002). A portion of this financing is earmarked for NGOs and decentralised co-operation.

FSP projects must be included in the DSP, if there is one. They are managed by technical assistants under the supervision of the SCAC in the recipient countries. These projects are devoted to: strengthening the rule of law and national and local government capacities; regional integration; regional planning and natural resource management; community development; human rights; social services; youth and sports; and promoting the French language and cultural activities. The FSP includes a decentralised fund, the Social Development Fund (FSD), which has been found a useful tool for poverty reduction and for fostering partnership with civil society by supporting local or French NGOs and promoting decentralised co-operation.

(ii) The AFD's project aid

The AFD has extensive experience with project aid. The projects it finances have long cycles, the amounts involved are substantial, and the work is contracted locally. The AFD provides funding for employment-generating productive projects, both public and private, in a wide variety of sectors. In addition to the environment, rural and urban development, microfinance, and new information and communication technologies, the AFD is now expanding its investment into natural resource management, finance, regional planning, and vocational training. Since the 1998 reform, the agency's

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responsibilities have been broadened to include infrastructure in the health and education areas. In 2002, 57 projects were approved for total budget of EUR 548.5 million.

(iii) Better concentration for greater impact and visibility

Project aid allows for experimentation and hands-on familiarity with local realities. The adoption of the logical framework has introduced greater financial and technical discipline. It has reinforced the French presence in Francophone Africa, and has contributed to an understanding of local conditions, the forging of links between development partners, and the adaptation of aid to shifting circumstances in the host country. However, the scattered pattern of interventions betrays a lack of sector concentration, and makes the French effort less visible. It tends to spread financial and human resources too thinly, and imposes high transaction costs both for the French authorities and for the host country. From the delivery viewpoint, project aid is difficult to co-ordinate with the activities of other donors, and it is cumbersome and time-consuming to administer.

The DAC missions noted that despite recent efforts to focus aid in Benin and in Mauritania, French co-operation is still spread over many projects at a time of staffing cutbacks. Since the 1998 reform the SCAC has been bound by the complex procedures of the MAE, which have tended to delay project implementation. The delegation of project management to partners in the host country, accompanied by ex-post controls, would improve the situation and would reinforce national ownership of projects. It would also have the advantage of allowing the embassies to focus on strategic planning. This approach is already in use for the FSD, and could be extended to all FSP projects.

In general terms, French co-operation activities should be defined and implemented in co-ordination and consultation with the partner countries, in the context of their development strategies. Thought should be given to greater geographic selectivity and to refocusing aid on a few sectors and issues in which French co-operation has particular strengths. In this spirit, France could make a distinction between countries of concentration and those in which it will continue with *ad hoc* operations for reasons of solidarity with people in difficulty, as the AFD is now doing. It would also be advisable to integrate the regional dimension into some sectors and to encourage partnerships with different components of civil society (OSIs, local governments and entrepreneurs), and with other donors, depending on comparative advantage. Finally, for the sake of transparency and coherence in the French effort, there should be list of conditions that must be fulfilled before delivery mechanisms other than project aid can be used.

Moving to the programme approach and using the C2D

The programme approach is gaining ground, thanks to the use of the C2D (see Chapter 2), whereby French co-operation can assist the local authorities in defining the detailed components of programmes, in verifying that funds are properly allocated through the use of essentially *ex-post* controls based on mutually agreed operational and results indicators, and in strengthening national administrative and technical capacities. Co-ordination with other donors is another goal within this framework. The C2Ds have the potential to adapt the FSP for the move to the programme approach, for which it would seem that French co-operation is still ill equipped.

There is some question about the rationale for creating a new mechanism that might be called an accounting device, rather then moving forward with straightforward debt reduction and budget support, as other donors are increasingly doing under the PRSP. Resort to the C2D reflects the concern of French co-operation to ensure sound programme implementation and to control the expenditure chain. The French authorities should reconsider the costs and benefits of the C2D approach in comparison with debt forgiveness, on one hand, and budget support on the other. Such an approach

would be useful for determining the appropriateness of providing more budgetary aid to countries that are successful in controlling their public spending.

One of the challenges facing French co-operation is to help partner countries to frame sector strategies prior to the completion point for identifying the target areas for C2D allocations. There are several tools that lend themselves to this purpose: technical assistance for capacity building, the FSP to support implementation of the PRSP, and the AFD's programme preparation fund. The urgency of establishing high-quality sector programmes should not be allowed to undermine the participatory process for their delivery. Another challenge is to involve NGOs and decentralised co-operation partners in implementing the C2D. Although the co-operation authorities show a certain willingness to move towards the programme approach, as the programme in Mauritania demonstrates (see Box 8), neither the procedures nor the channels for making this shift have been defined. The decision-making process within the MAE and the AFD is still highly centralised, even if programme and project identification, preparation and execution have now been delegated to field representatives, and it will have to be adapted to this form of co-operation, which demands great flexibility. It is with this in mind that the next C2D for Cameroon calls for the creation of a steering and monitoring committee, the membership of which will be negotiated with the national authorities, and could be opened to civil society and other donors. The committee will provide an opinion on programmes eligible for C2D financing, which will be attached to the documentation submitted to the AFD Supervisory Board for decision.

Technical assistance: an evolving instrument

Technical assistance (TA) is a specialty of French co-operation. It is one of the MAE's key tools, along with education grants and training programs, and an important vehicle for French influence abroad. The technical assistants play a major role, with their know-how and their concern for efficiency, in the technical and financial management of projects and in structuring central and local government institutions. Most technical assistants are public servants or high-level technicians seconded from French ministries to government departments in partner countries.

Before the co-operation reform, TA was the target of some criticism. A mission report (Nemo, 2000) on personnel support in co-operation activities concluded that such assistance did little to upgrade skills and adapt aid to needs, that it held back the transfer of skills to local managers, and tended to absolve the local elites of their responsibilities, while impeding the employment of local staff in project implementation. In the end, "the ease of recourse to technical assistance may have caused other, possibly more appropriate formulas to be overlooked", such as subcontracting and consulting services (Senate, 2001).

TA is a sound tool, provided it is used carefully and transparently. In Benin, as elsewhere in Africa, the use of such assistance has not always been synonymous with capacity building, even where this was a specific objective of the programmes in question, and provisions for continuity with national personnel were not always systematic. This is a particularly costly form of aid (EUR 6 million out of a total of EUR 20 million in Mauritania), and tends to emphasise the bilateral relationship. It may even be resented by national personnel who will consider that their skills are at least as good as those of some technical assistants. There is also the question of whether the activities will be sustained once the TA has been completed.

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Box 8. An effective partnership in the education sector in Mauritania

In 2001, the Mauritanian Government began to implement a ten-year programme, the PNDSE, which covers the entire national education system. The quality of this programme and the conditions surrounding its implementation having been considered satisfactory, Mauritania was able to qualify for the "Education for All Fast-Track Initiative" in June 2002.

France's support for the education sector is provided in the following different ways: an FSP project of institutional support for the reform of the education system (EUR 1.8 million); technical assistance (20 persons, at a cost of EUR 8 million); and the financing of the implementation of the PNDSE through the C2D (EUR 9.8 million). The C2D contribution is provided in the form of budgetary aid allocated for the renovation and construction of primary schools and teacher training. Direct support for the PNDSE (not including technical assistance) accounts for 9.5% of the total budget of the first phase of the programme.[1] The resources allocated by France to the basic education sector over the next three years (approximately EUR 20 million) have virtually doubled.

The PNDSE was set up under the authority of the Prime minister on the basis of a participatory, iterative and multisectoral approach that involves all stakeholders. French TA has played a key role in this process, in particular by performing a diagnosis of the functioning of the sector, identifying needs and defining an intervention strategy in close co-operation with a dynamic and motivated national team. The Mauritanian authorities have appreciated the contribution made by French TA since the management skills were not necessarily available within the Education Ministry. This assistance has thus provided support for the process under way and brought profound changes in attitudes and behaviour, with technical assistants having to learn to listen closely to their local partners and Mauritanians having to take initiatives within particularly short time frames. TA in the education sector is an example of a high-quality service adapted to needs because of the well-organised sectoral framework in which it was provided. The political commitment to reform of the education sector, and the determination on the Mauritanian side to become actively involved in the process, has facilitated the transfer of skills that could ultimately lead to Mauritanians taking over the programme entirely.

The steering of the PNDSE is based on annual programming through consolidated action plans for each component. An interministerial team set up for this purpose monitors implementation. Donors are involved in the process through jointly organised oversight missions, annual reviews and mid-term appraisals. Donors have managed to make progress in establishing a common approach while continuing to operate through project aid. Each of their projects financed within the programme retains its own management structure, action plan - which must be in line with the PNDSE - and activity report. This has made for substantial progress in strategic alignment, but much remains to be done as regards the harmonisation of procedures (joint accounts, financial management and common audits). The C2D is a positive step, but by maintaining three different aid initiatives in this sector alone, France is not helping to reduce the administrative burden that aid management places on its Mauritanian partners.

1. The rest of the financing is provided by the World Bank (53%), the African Development Bank (16%), the Islamic Development Bank (12%) and UNICEF (6%). The government's contribution (including the resources made available by debt cancellations under the HIPC initiative) accounts for 15%.

The government has made profound changes to technical assistance since 1997. The number of technical assistants assigned to the ZSP has been cut back considerably (from more than 20 000 in the 1980s to around 2 200 in 2004), and their objective has changed as well: the current trend is to send out missions of short or medium duration, depending on need, to integrate this assistance into projects or programmes, and to make training the central focus of French technical co-operation. Embassy staff reductions have meant that some TAs are now serving as advisers to the SCAC, a situation that can sometimes produce a conflict of interest. At the same time, two specialised organisations (*groupements d'intérêt public*) have been created in order to promote French expertise internationally. "*France Coopération Internationale*", a branch of the MAE, is responsible for developing countries, while the ADETEF (*Assistance au développement des échanges en technologies économiques et financières*) is a sub-body of the Treasury, providing technical and financial co-operation in

transitioning countries. For its part, the AFD training centre, CEFEB, contributes to capacity building for local project contractors.

In Benin, the DAC mission found that TA was coupled with institutional projects or programmes and that it was serving strategic goals, often at the request of the local authorities or other donors. Its capacity building impact can be seen at the local level (for example, among farmers' organisations and local governments). Its impact is less visible, and harder to measure, when it comes to supporting policymakers in the sector ministries, where the technical assistant is unlikely to be replaced by a local successor. In Mauritania, the mission was struck by the high level of professional dedication of the technical assistants, and by their recognition that there were strict time limits on their mission, during which they had to transfer skills. It would seem that French co-operation in this country has moved from the notion of "substitution" to the "engineering of training", and that the future will see a better match between supply and demand.

French co-operation has a tradition of doing things itself rather than having them done by others. From the project design stage onwards, it would be well to plan for the time when TA comes to an end, and to consider the best way to strengthen the local teams that will take over. It would also be better not to confine national personnel to technical roles, but to give them project management responsibilities, and to rely more frequently on local or outside NGOs for the less technical tasks. Because they are close to users, local personnel and NGOs are well placed to foster synergies through their involvement. There should also be more emphasis on identifying TA needs jointly with local partners in each field of intervention, and on evaluating, again jointly, the impact of TA on project objectives.

Greater advantage could be taken of the possibilities for pooling donor funding for TA. The new functions inherent in PRSP implementation and in the programme approach should facilitate this. Following the example of the human resource databases that some donors have established, France could consider creating "expertise nurseries" based on an inventory of local or regional expertise.

Field presence and organisation: a composite set of players

The 1998 reform led to reorganisation of the French co-operation presence in the field, especially in sub-Saharan African countries. Co-ordination of those players is now in the hands of each ambassador, assisted by the head of the SCAC. The local presence consists of:

- The SCAC, which is responsible for managing the FSP-funded technical co-operation and the education grants and training programmes provided by all the French ministries.
- The AFD, which enjoys a degree of management autonomy, but whose projects are included in the DSP and must be approved by the ambassador.
- A military and defence co-operation mission that includes one or more defence attachés and advisors (*coopérants*).
- A *Service de coopération technique international de la police* headed by an internal security attaché backed by two technical advisers.
- An economic mission attached to the MINEFI, whose staff are the contacts for French firms. With the recent merger of the DREE and Treasury networks (see Chapter 5), these missions are also beginning to establish liaison with local representatives of the IFIs.
- The French cultural centres, the *Alliances françaises*, and the French *lycées*.

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- The list also includes numerous other players from the public and private sectors, the world of research and voluntary associations: (i) decentralised co-operation bodies, which act independently and have their own funding but also receive MEA funding; (ii) French NGOs, most of which also receive cofinancing from the MAE; and (iii) research institutes, including IRD and CIRAD.

The DAC mission wondered how all these more or less independent players, with their often very different professional cultures, could be brought together to work as a team towards the development objectives set by the partner countries, and whether there was not a risk of isolation or compartmentalisation between these players in the various areas in which they work. Whether in Benin or in Mauritania, it seemed that consultation and co-operation between the senior members of the team (the SCAC and the AFD) was functioning which, in the opinion of the mission, was a positive factor that could help to improve synergies between the different types of activity. However, this co-operation is less effective in other countries, particularly when it comes to implementing the C2D. Moreover, donors generally underestimate the time needed, at least at the initial stage, to implement new approaches for harmonising and aligning their practices and procedures. This problem is amplified in the case of the French co-operation system, which is particularly complex, and it would seem to call for a greater allocation of field resources to the functions of analysis, co-ordination and consultation. In all cases, one of the greatest difficulties facing staff posted abroad is to co-ordinate the activities of NGOs and decentralised co-operation partners around common objectives, in light of the great decision-making and operational autonomy those players enjoy.

Making the AFD responsible for infrastructure in the social sectors presupposes closer co-operation with the SCAC, which oversees other aspects of co-operation linked to these sectors (for example, health and education policy). The closeness of such co-operation varies, depending on the country, the sector, and the personalities involved. According to one recent report, the division of roles between the two institutions occurs naturally without serious overlap or friction in the agriculture sector, where the FSP finances experiments that the AFD manages on a broader scale, with MAE technical assistance providing the link between the administration and the local AFD officer. In other fields, such as decentralisation, social development and health, co-operation appears inadequate (*Réseau Impact*, 2003). In Benin, the SCAC-AFD arrangement works well for applied research (water and health, cotton and staple crops). In Mauritania, synergies are most evident in the fields of education, urban development, and support for decentralisation.

Notwithstanding the efforts to achieve complementarity among the various players and fields of intervention, the risk of overlapping between the activities of the MAE and those of the AFD exists, and having these two institutions involved in the same field is costly. The issue becomes all the more urgent with adoption of the programme approach, where the distinction between financing for infrastructure and for institutional support has no rationale.

Co-ordination with other donors

Opportunities waiting to be seized

The DAC missions to Benin and Mauritania found that co-ordination among donors in partner countries depends on a number of factors, including the quality of interpersonal relationships and the willingness of certain professionals to network and to join with other donors around one or several common objectives. The fewer donors there are, the easier the task may appear, since too many institutional cultures can hinder co-ordination. The determination and the capacity of the host country government to take responsibility for co-ordination will also be decisive for bringing coherence to the various donors' activities.

In Mauritania, the small number of donors (five bilateral donors, plus the multilateral institutions) forms a relatively homogeneous community within which France plays a key role in certain sectors (education, decentralisation, and water). Complementarity between the European Union and France could be better reflected in some areas (water, for example) through joint missions and the co-ordination of technical assistance. In Benin, donor co-ordination suffers, on one hand, from the delay in instituting a mechanism for co-ordination and dialogue with government, and on the other hand, from the local authorities' reluctance to assume the responsibility, and a real lack of leadership. In the opinion of persons interviewed, France could be more active in putting forward its own initiatives and proposals within the thematic groups.

Whatever the host country, donor co-ordination can be hampered by the variety of contact points in partner-country ministries and the differing procedures used by bilateral and multilateral donors. This situation is beginning to change, with the adoption of the programme approach and budget support. The PRSPs increasingly constitute the frame of reference for all donors, and can also help to improve co-ordination and harmonisation of their practices. From this viewpoint, the Mauritanian PRSP has promoted a good spirit of co-operation and task sharing between donors and reflects a strong sense of ownership on the part of the host country. France has adopted the PRSP as the frame of reference for all its activities. What is missing is the Mauritanian government's determination to establish an ongoing process of PRSP-focussed co-operation, especially at the sectoral level.

In general, France co-operates with other donors in sectors of common interest. For example, it is collaborating with the German assistance programme in decentralisation and natural resource management. The SCAC and the AFD are frequently in touch with the IFIs, with which they co-operate in a number of fields (government finance, decentralisation, urban management, the cotton sector). There is also co-ordination with United Nations agencies and the EU in sectors of convergence. Despite the progress of recent years, however, France needs to seek greater synergy with other donors, bilateral, European and multilateral, within the framework of national programmes prepared by the partner countries. Recent French statements in favour of harmonising aid practices should motivate the players to move in this direction.

Harmonising aid practices in the field

At its December 2002 meeting, the CICID laid down new directions for French co-operation: integrate aid into the programming frameworks of partner countries; support sectoral programmes; and provide budgetary assistance for poverty reduction programmes in countries that can offer assurance that such funds will be properly used. The drive to make French aid more effective has been gaining momentum both internally and internationally since the CICID decided to have a working group address this issue.

France was heavily involved in preparations for the 2003 meeting that adopted the Rome Declaration on Harmonisation. Within the DAC, it chairs the Working Party on Aid Effectiveness and Donor Practices, and has offered to host the high-level forum on this issue at the beginning of 2005. Donor co-ordination and harmonisation of their practices are intended to "reduce the transaction costs of delivering aid, to help strengthen the capacities of partner countries, and to encourage them to assert ownership over development strategies and policies". Harmonisation and greater aid effectiveness should contribute to achieving the MDGs, in particular objective 8, to create "a global partnership for development" (MINEFI, 2003).

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A joint MAE-AFD training programme was established in 2003 to make French co-operation managers familiar with the concepts and modalities of harmonisation. That programme seeks to bring about a change in professional practices, and should result in the updating of procedural manuals and operational guidelines for the entire French system.

France's high-level commitment to implementing sound practices for more effective aid is a positive sign. In the field, however, the DAC missions found that donors and partner countries have yet to internalise the principles of harmonisation. Only halting efforts have been made in this direction, even under the programme approach (see Box 8 on the education programme in Mauritania). As the international champion of this cause, France could be more active in putting into operation the principles that it and other donors have proclaimed.

Untying aid

In 2002, the CICID authorised the AFD to untie all project aid. Untying now applies to all operations, including studies financed through the Project Preparation Fund, regardless of the grant/loan amount or the beneficiary country. This is a welcome decision, representing an effort that goes beyond the 2001 DAC Recommendation on Untying ODA to the Least Developed Countries. That effort has not demanded any great adjustments within the agency, which has long used national bidding procedures and local prime contractors for project delivery.

The DAC recommendation excludes technical assistance in order to maintain support for development assistance among the public in donor countries. That situation could change with the international commitment to make aid more effective through harmonisation. On this point, France could lead the way towards untying aid in favour of using local and regional expertise as a means of encouraging developing countries to take responsibility for their own development, and as a way of promoting efforts sharing in untying among DAC members.

Points for consideration

- Clarify the procedures for preparing the DSPs, link them to the PRSPs, and implement the principles of partnership. Gear aid programming to the needs expressed by the partner countries through the PRSPs, rather than as a function of the tools of co-operation. Assess the efficacy of these instruments within the programme or sectoral approach, on the basis of experience, so that assistance strategies and modalities can be adjusted if necessary.
- Pursue efforts to adjust technical assistance to strengthen its contribution to capacity building, while assessing its opportunity cost compared with other instruments. Consider untying such assistance, co-financing with other donors and increased use of local or regional expertise.
- Take a more active role in the application of the principles of aid effectiveness in partner countries: this will entail finalising and disseminating the action plan for harmonisation and specifying the objectives to be achieved, accompanied by a list of results indicators.

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ANNEX A

RECOMMENDATIONS FROM THE 2000 DAC EXAMINATION:

STATUS OF IMPLEMENTATION

Main points	Recommendations	Progress to date
Aid volume	Use the increased fiscal revenues generated by the return of stronger growth to increase the volume of aid. Make a special budgetary effort to maintain or increase aid flows, following the shift from loans to grants for countries eligible for the enhanced HIPC initiative.	In 2002 France undertook to increase its ODA to 0.5% of GNP by 2007 and to 0.7% by 2012. ODA resumed growth in 2001, and continued to rise in 2002 and 2003. At present, most of the increase in ODA reflects debt relief. In the near future, as more HIPCs reach the completion point, steps will have to be taken to maintain or increase the level of ODA.
Strategic framework	Utilise the CICID to draw up rapidly and make public a strategy outline focusing on poverty reduction, containing a ranking of objectives and capable of serving as a reference to all actors in the aid system.	The CICID could perhaps play a more active role in driving strategic ODA choices and monitoring implementation. Reducing poverty and inequality is now an integral part of French co-operation. However, this is not yet reflected in a policy document that would provide guidance for the entire system.
Geographic concentration	Review the consistency of the ZSP in such a way as to tighten it around a smaller number of countries, and select the priority recipients in such a way as to refocus aid on the poorest countries and those pursuing appropriate policies.	The ZSP covers 54 countries potentially eligible for ODA. This is not a sufficient criterion for geographic selectivity. Priority for Africa has been confirmed. Explicit rules of budgetary allocation by country are to be prepared.
Country strategies	Set in place rapidly, for the priority recipients, country strategies that are discussed with the partners and made accessible to the public.	DSPs have been prepared for 14 countries and 19 other documents are pending approval. Most have not been discussed with partners, nor have they been published.
Emerging countries reserve (RPE - formerly the *protocoles financiers*)	Continue the process of reducing aid supplied by the MINEFI in the form of financial protocols.	RPE disbursements declined by 45% from 1999 to 2003. ../..

Basic social sectors	Increase the aid earmarked for the basic social sectors, in particular by augmenting the resources allocated to the AFD for this purpose.	France is committed to linking its cooperation activities to the MDGs. The program approach is given priority under the Education for All initiative, but the basic education share in ODA is still low (4%). In health, France emphasizes the fight against HIV/AIDS and has tripled its contribution to the Global Fund to Fight AIDS, Tuberculosis and Malaria (EUR 150 million per year as of 2004).
Gender equality	Continue the efforts begun to systematically integrate the concern of gender equality into all aid activities.	French policy is taking greater account of gender, but this dimension has not yet been mainstreamed throughout the system.
Aid evaluation	Improve the aid evaluation system, at present very fragmented, with a view to enhancing evaluation independence, transparency and feedback.	Evaluation has been strengthened in terms of methodology, coverage and feedback. Further progress is needed in disseminating reports, internalizing lessons learned and assessing impact.
Information and awareness raising	Consider the advisability of introducing a specific policy of public opinion information and awareness raising.	The French authorities pay as little attention as ever to information and public awareness questions. There is no annual report covering ODA as a whole.
Untying aid	Pursue current efforts to reach consensus on untying aid to LDCs.	Since 2002, all AFD funding has been untied for all developing countries.

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ANNEX B

LISTS OF COUNTRIES ELIGIBLE FOR ODA

1. The *Zone de solidarité prioritaire* (ZSP)

Following the CICID meeting on 14 February 2002, the ZSP now covers the following 54 countries:[18]

Near East: Lebanon, zones under Palestinian administration, and Yemen**.**

North Africa: Algeria, Morocco and Tunisia.

Sub-Saharan Africa and Indian Ocean: South Africa, Angola, Benin, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Congo, Côte d'Ivoire, Djibouti, Eritrea, Ethiopia, Gabon, Ghana, Gambia, Guinea, Guinea-Bissao, Equatorial Guinea, Kenya, Liberia, Madagascar, Mali, Mauritania, Mozambique, Namibia, Niger, Nigeria, Uganda, Democratic Republic of the Congo, Rwanda, São-Tomé and Principe, Senegal, Sierra Leone, Sudan, Tanzania, Togo and Zimbabwe.

South-east Asia: Cambodia, Laos and Vietnam.

Caribbean: Cuba, Haiti, Dominican Republic.

Latin America: Surinam.

Pacific: Vanuatu.

2. The *Réserve pays émergents*

The list of eligible countries is set each year by the MINEFI. They are for the most part emerging or transition countries that have reached a stage of development which allows them at least a minimum of access to international capital markets, and have good growth potential. The list has been relatively stable in recent years, and includes the following countries in 2004:

South Africa, Algeria, Azerbaidjan, China, Egypt, Indonesia, Kazakhstan, Morocco, Philippines, Serbia and Montenegro, Tunisia, Turkey and Vietnam ; five Latin American countries (Bolivia, Colombia, Guatemala, Peru and El Salavador) and Uzbekistan are eligible in case of cofinancing with other donors.

3. C2D eligible countries

There are 22 countries on the list: Côte d'Ivoire, Cameroon, Congo, Democratic Republic of the Congo, Guinea, Liberia, Mozambique, Madagascar, Mauritania, Burundi, Ghana, Rwanda, Uganda, Tanzania, São Tomé and Principe, Sierra Leone, and Sudan ; and five non-ZSP countries: Bolivia, Honduras, Malawi, Myanmar and Nicaragua.

18. Changes to the list are minor and involved removing countries in the upper bracket of middle-income countries (Mauritius, Seychelles and a series of countries in the Lesser Antilles), while adding Sudan and Yemen.

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ANNEX C

OECD/DAC STANDARD SUITE OF TABLES

Table C.1. Total financial flows

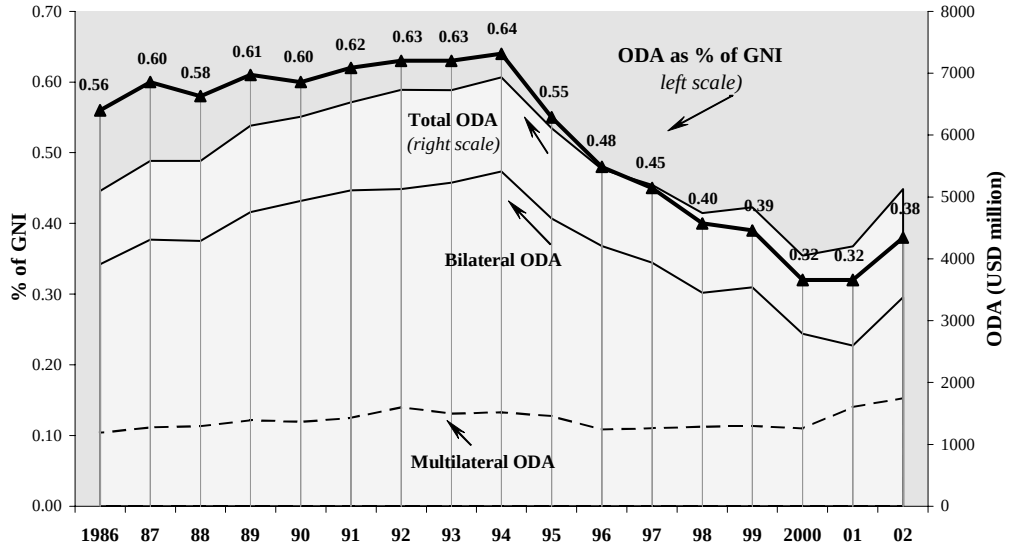
USD million at current prices and exchanges rates

Net disbursements

France	1986-87	1991-92	1998	1999	2000	2001	2002
Total official flows	**5 890**	**9 135**	**6 374**	**6 369**	**5 742**	**5 418**	**7 606**
Official development assistance	4 646	7 828	5 742	5 639	4 105	4 198	5 486
Bilateral	3 575	6 037	4 185	4 128	2 829	2 596	3 615
Multilateral	1 071	1 791	1 557	1 512	1 276	1 602	1 871
Official aid	**n.a.**	**410**	**823**	**745**	**1 657**	**1 334**	**1 464**
Bilateral		107	495	336	1 084	1 011	1 063
Multilateral		303	327	408	573	323	401
Other official flows	**1 244**	**897**	**- 191**	**- 15**	**- 20**	**-113**	**656**
Bilateral	1 244	897	- 191	- 15	- 20	-113	656
Multilateral	-	-	-	-	-	-	-
Grants by NGOs	**95**	**244**	**-**	**-**	**-**	**-**	**-**
Private flows at market terms	**1 483**	**133**	**9 744**	**11 753**	**11 832**	**33 872**	**2 960**
Bilateral: *of which*	761	170	9 744	11 753	11 832	33 872	2 960
Direct investment	653	1 402	8 767	9 469	7 961	13 449	4 840
Export credits	- 188	- 576	145	- 388	-	-30	-1647
Multilateral	723	- 37	-	-	-	-	-
Total flows	**7 468**	**9 512**	**16 118**	**18 122**	**17 574**	**39 291**	**10 566**
for reference:							
ODA (at constant 2001 $ million)	*5 343*	*6 631*	*4 740*	*4 834*	*4 047*	*4 198*	*5 125*
ODA (as a % of GNI)	*0.58*	*0.62*	*0.40*	*0.39*	*0.32*	*0.32*	*0.38*
Total flows (as a % of GNI) (a)	*0.93*	*0.69*	*0.59*	*0.64*	*0.43*	*1.24*	*0.33*

a. To countries eligible for ODA.

ODA net disbursements
At constant 2001 prices and exchange rates and as a share of GNI



Source: OECD.

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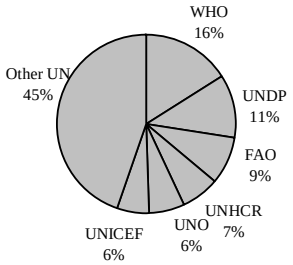
Table C.2. ODA by main categories

Disbursements

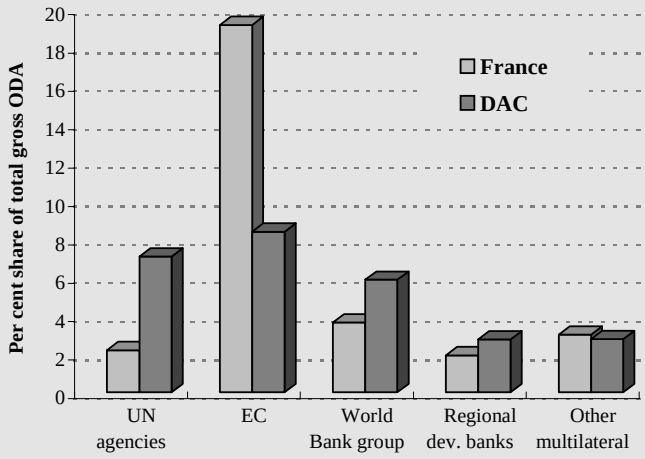
France	Constant 2001 USD million					Per cent share of gross disbursements					Total DAC
	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002	2002%
Gross Bilateral ODA	**4 366**	**4 270**	**3 565**	**3 387**	**4 401**	**76**	**76**	**72**	**66**	**70**	**73**
Grants	***3 748***	***3 706***	***3 072***	***2 920***	***3 619***	***65***	***66***	***62***	***57***	***58***	***60***
Project and programme aid	410	377	654	447	431	7	7	13	9	7	12
Technical co-operation	1 718	1 684	1 265	1 337	1 425	30	30	26	26	23	24
Developmental food aid	43	44	46	52	31	1	1	1	1	0	2
Emergency and distress relief	73	167	157	211	240	1	3	3	4	4	6
Action relating to debt	1 017	1 008	675	596	1 216	18	18	14	12	19	8
Administrative costs	224	213	186	179	181	4	4	4	3	3	5
Other grants	262	212	88	99	95	5	4	2	2	2	4
Non-grant bilateral ODA	***619***	***564***	***493***	***466***	***782***	***11***	***10***	***10***	***9***	***12***	***13***
New development lending	552	543	406	352	518	10	10	8	7	8	**11**
Debt rescheduling	67	21	87	114	264	1	0	2	2	4	**1**
Acquisition of equity and other	-	-	-	-	-	-	-	-	-	-	**1**
Gross Multilateral ODA	**1 368**	**1 385**	**1 364**	**1 725**	**1 876**	**24**	**24**	**28**	**34**	**30**	**27**
UN agencies	99	102	123	109	137	2	2	2	2	2	7
EC	646	685	780	1 043	1 202	11	12	16	20	19	8
World Bank group	193	192	239	232	228	3	3	5	5	4	6
Regional development banks (a)	116	122	82	109	121	2	2	2	2	2	3
Other multilateral	314	285	140	233	188	5	5	3	5	3	3
Total gross ODA	**5 735**	**5 655**	**4 929**	**5 112**	**6 278**	**100**	**100**	**100**	**100**	**100**	**100**
Repayments and debt cancellation	**- 995**	**- 821**	**- 882**	**- 914**	**-1 152**						
Total net ODA	**4 740**	**4 834**	**4 047**	**4 198**	**5 125**						
For reference:											
ODA to and channelled through NGOs	*18*	*27*	*29*	*27*	*28*						
Associated financing (b)	-	-	-	-	-						

a Excluding EBRD.
b. ODA grants and loans in associated financing packages.

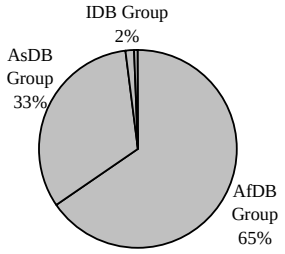
Contributions to UN Agencies (2001-02 Average)



ODA flows to multilateral agencies, 2002



Contributions to Regional Development Banks (2001-02 Average)

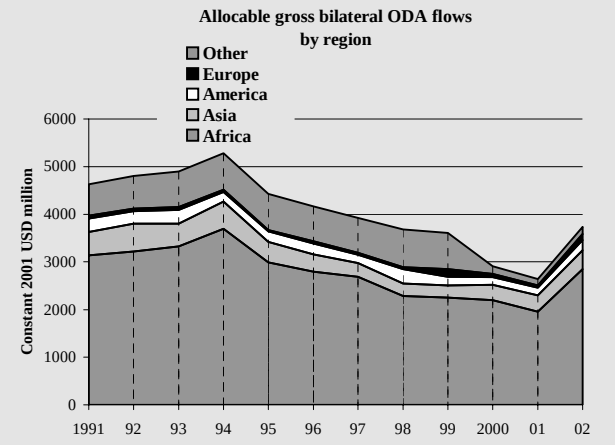


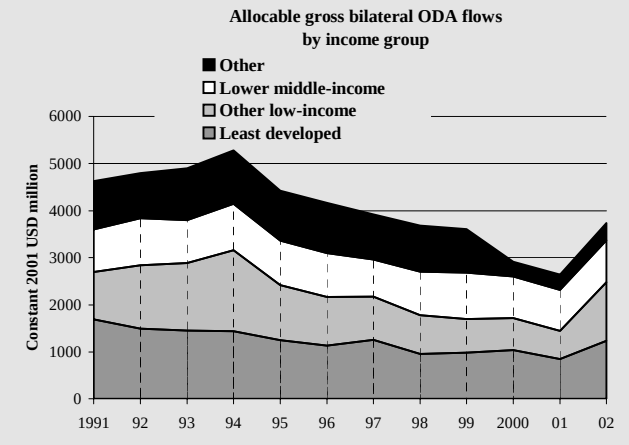
Source: OECD.

Table C.3. Bilateral ODA allocable by region and income group

Gross disbursements

France	Constant 2001 USD million					Per cent share					Total DAC
	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002	2002%
Africa	2 283	2 248	2 192	1 952	2 850	62	62	75	74	76	**36**
Sub-Saharan Africa	1 629	1 606	1 559	1 309	2 311	44	45	54	50	62	**30**
North Africa	654	642	633	643	539	18	18	22	24	14	**6**
Asia	261	258	327	343	397	7	7	11	13	11	**36**
South and Central Asia	73	60	103	91	63	2	2	4	3	2	**17**
Far East	188	198	224	251	334	5	6	8	10	9	**20**
America	301	179	161	162	211	8	5	6	6	6	**13**
North and Central America	196	78	66	71	72	5	2	2	3	2	**5**
South America	105	102	95	91	138	3	3	3	3	4	**8**
Middle East	96	95	103	77	86	3	3	4	3	2	**4**
Oceania	693	659	62	58	57	19	18	2	2	2	**2**
Europe	43	165	64	48	130	1	5	2	2	3	**9**
Total bilateral allocable by country	**3 677**	**3 606**	**2 909**	**2 640**	**3 731**	**100**	**100**	**100**	**100**	**100**	**100**
Least developed	955	982	1 042	849	1 238	26	27	36	32	33	**29**
Other low-income	824	715	671	596	1 238	22	20	23	23	33	**31**
Lower middle-income	924	984	891	867	892	25	27	31	33	24	**35**
Upper middle-income	318	305	305	327	362	9	8	10	12	10	**6**
High-income	1	1	1	1	2	0	0	0	0	0	**0**
More advanced developing countries	655	618	-	-	-	18	17	-	-	-	**-**
For reference:											
Total bilateral	4 366	4 270	3 565	3 387	4 401	*100*	*100*	*100*	*100*	*100*	***100***
of which: Unallocated	*689*	*664*	*655*	*747*	*670*	*16*	*16*	*18*	*22*	*15*	***22***





Source: OECD.

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Table C.4. Main recipients of bilateral ODA

Gross disbursements, two-year averages

France	1991-92				1996-97				2001-02		
	Current USD million	Constant 2001 USD mn.	Per cent share		Current USD million	Constant 2001 USD mn.	Per cent share		Current USD million	Constant 2001 USD mn.	Per cent share
Côte d'Ivoire	422	356	8	French Polynesia	421	326	8	Côte d'Ivoire	432	409	13
New Caledonia	344	291	6	New Caledonia	395	306	8	Mozambique	239	224	7
French Polynesia	333	283	6	Côte d'Ivoire	375	287	7	Morocco	222	215	7
Cameroon	326	271	6	Egypt	295	229	6	Egypt	184	179	6
Morocco	280	239	5	Cameroon	285	221	5	Cameroon	144	138	4
Top 5 recipients	**1 705**	**1 440**	**31**	**Top 5 recipients**	**1 771**	**1 369**	**34**	**Top 5 recipients**	**1 221**	**1 165**	**37**
Senegal	269	229	5	Morocco	284	217	5	Senegal	139	134	4
Egypt	233	195	4	Congo, Rep.	271	212	5	Mayotte	125	121	4
Algeria	203	171	4	Madagascar	247	197	5	Tunisia	121	117	4
Indonesia	163	138	3	Senegal	208	161	4	Indonesia	93	89	3
Madagascar	157	133	3	Algeria	191	146	4	Algeria	83	80	3
Top 10 recipients	**2 729**	**2 306**	**49**	**Top 10 recipients**	**2 973**	**2 302**	**57**	**Top 10 recipients**	**1 781**	**1 706**	**54**
China	146	124	3	Gabon	138	105	3	Mali	79	77	2
Guinea	130	109	2	Mayotte	113	87	2	China	79	76	2
Burkina Faso	130	110	2	Niger	107	83	2	Viet Nam	75	72	2
Niger	119	101	2	Tunisia	96	74	2	Serbia & Montenegro	63	59	2
Tunisia	106	90	2	Burkina Faso	91	70	2	Burkina Faso	62	60	2
Top 15 recipients	**3 360**	**2 840**	**60**	**Top 15 recipients**	**3 518**	**2 721**	**67**	**Top 15 recipients**	**2 139**	**2 049**	**64**
Gabon	103	88	2	Mali	84	65	2	Gabon	61	59	2
Mali	98	84	2	China	74	56	1	Madagascar	59	57	2
Congo, Rep.	92	79	2	Guinea	70	55	1	Wallis & Futuna	51	50	2
Mozambique	92	78	2	Viet Nam	70	54	1	Benin	50	48	2
Chad	90	77	2	Chad	67	51	1	Niger	45	44	1
Top 20 recipients	**3 835**	**3 246**	**69**	**Top 20 recipients**	**3 882**	**3 002**	**74**	**Top 20 recipients**	**2 405**	**2 307**	**73**
Total (140 recipients)	**5 568**	**4 716**	**100**	**Total (147 recipients)**	**5 228**	**4 043**	**100**	**Total (144 recipients)**	**3 317**	**3 185**	**100**
Unallocated	1 014	860		Unallocated	1 120	868		Unallocated	732	709	
Total bilateral gross	**6 582**	**5 576**		**Total bilateral gross**	**6 349**	**4 911**		**Total bilateral gross**	**4 049**	**3 894**	

Source: OECD.

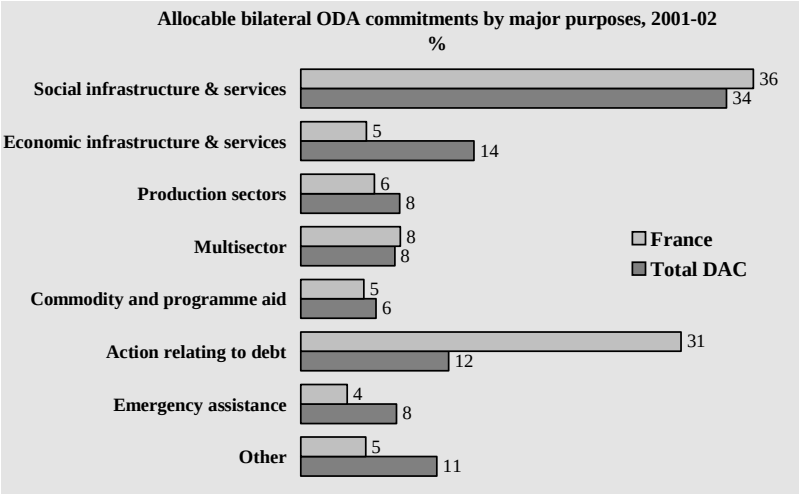
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Table C.5. Bilateral ODA by major purposes

at current prices and exchange rates

Commitments, two-year averages

France	1991-92		1996-97		2001-02		
	USD million	Per cent	USD million	Per cent	USD million	Per cent	Total DAC per cent
Social infrastructure & services	**2 088**	**37**	**2 655**	**49**	**1 418**	**36**	**34**
Education	1 442	25	1 709	31	851	22	9
of which: basic education	-	-	-	-	152	4	2
Health	181	3	198	4	172	4	5
of which: basic health	-	-	-	-	50	1	3
Population programmes	-	-	-	-	8	0	3
Water supply & sanitation	138	2	270	5	141	4	4
Government & civil society	141	2	105	2	36	1	8
Other social infrastructure & services	185	3	373	7	211	5	6
Economic infrastructure & services	**787**	**14**	**522**	**10**	**206**	**5**	**14**
Transport & storage	254	4	257	5	89	2	7
Communications	191	3	67	1	28	1	0
Energy	228	4	144	3	34	1	4
Banking & financial services	2	0	1	0	35	1	1
Business & other services	112	2	54	1	19	0	1
Production sectors	**767**	**13**	**492**	**9**	**231**	**6**	**8**
Agriculture, forestry & fishing	472	8	364	7	201	5	6
Industry, mining & construction	215	4	51	1	25	1	1
Trade & tourism	26	0	76	1	6	0	1
Other	52	1	-	-	0	0	0
Multisector	**365**	**6**	**441**	**8**	**312**	**8**	**8**
Commodity and programme aid	**944**	**17**	**312**	**6**	**198**	**5**	**6**
Action relating to debt	**478**	**8**	**668**	**12**	**1 190**	**31**	**12**
Emergency assistance	**26**	**0**	**16**	**0**	**145**	**4**	**8**
Administrative costs of donors	**227**	**4**	**285**	**5**	**184**	**5**	**6**
Core support to NGOs	**13**	**0**	**27**	**0**	**18**	**0**	**5**
Total bilateral allocable	**5 693**	**100**	**5 465**	**100**	**3 902**	**100**	**100**
For reference:							
Total bilateral	*6 102*	*77*	*5 529*	*76*	*3 986*	*69*	*73*
of which: Unallocated	*409*	*5*	*64*	*1*	*84*	*1*	*3*
Total multilateral	*1 791*	*23*	*1 752*	*24*	*1 805*	*31*	*27*
Total ODA	***7 893***	***100***	***7 282***	***100***	***5 792***	***100***	***100***



Source: OECD.

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Table C.6. Comparative aid performance

Net disbursements

	Official development assistance 2002		Official development assistance 96-97 to 01-02 Ave. annual % change in real terms	Grant element of ODA (commitments) 2002	Share of multilateral aid 2002				ODA to LDCs Bilateral and through multilateral agencies 2002		Official aid 2002	
					% of ODA		% of GNI					
	USD million	% of GNI		% (a)	(b)	(c)	(b)	(c)	% of ODA	% of GNI	USD million	% of GNI
Australia	989	0.26	2.4	100.0	21.8		0.06		19.4	0.05	7	0.00
Austria	520	0.26	5.2	96.1	30.0	11.2	0.08	0.03	32.6	0.08	196	0.10
Belgium	1 072	0.43	7.1	100.0	33.6	14.1	0.15	0.06	32.9	0.14	97	0.04
Canada	2 006	0.28	-0.6	99.9	25.1		0.07		17.4	0.05	104	0.01
Denmark	1 643	0.96	2.8	100.0	36.8	30.2	0.35	0.29	33.3	0.32	167	0.10
Finland	462	0.35	5.1	100.0	45.6	31.9	0.16	0.11	33.3	0.12	67	0.05
France	5 486	0.38	-2.6	99.6	34.1	10.7	0.13	0.04	29.6	0.11	1 464	0.10
Germany	5 324	0.27	-0.5	99.4	37.5	13.9	0.10	0.04	25.0	0.07	780	0.04
Greece	276	0.21	9.6	..	61.3	15.8	0.13	0.03	13.4	0.03	16	0.01
Ireland	398	0.40	14.3	100.0	32.8	17.0	0.13	0.07	52.8	0.21	26	0.03
Italy	2 332	0.20	4.6	100.0	56.8	24.2	0.11	0.05	44.8	0.09	..	..
Japan	9 283	0.23	3.0	87.7	27.9		0.06		19.5	0.04	99	0.00
Luxembourg	147	0.77	13.5	100.0	21.2	11.5	0.16	0.09	39.6	0.30	10	0.05
Netherlands	3 338	0.81	3.6	100.0	26.6	20.4	0.22	0.17	35.3	0.29	211	0.05
New Zealand	122	0.22	3.5	100.0	24.7		0.06		25.0	0.06	1	0.00
Norway	1 696	0.89	2.8	100.0	32.5		0.29		36.9	0.33	45	0.02
Portugal	323	0.27	6.7	100.0	42.3	19.6	0.11	0.05	37.3	0.10	33	0.03
Spain	1 712	0.26	9.5	100.0	41.7	17.4	0.11	0.05	14.7	0.04	11	0.00
Sweden	1 991	0.83	5.2	100.0	37.2	33.0	0.31	0.28	31.6	0.26	107	0.04
Switzerland	939	0.32	2.3	100.0	18.6		0.06		26.6	0.08	66	0.02
United Kingdom	4 924	0.31	6.5	100.0	28.8	10.0	0.09	0.03	23.4	0.07	494	0.03
United States	13 290	0.13	6.8	100.0	20.5		0.03		22.7	0.03	2 313	0.02
Total DAC	58 274	0.23	3.5	97.8	30.1	20.3	0.07	0.05	26.0	0.06	(6317.2)	(0.03)
Memo: Average country effort		0.41										

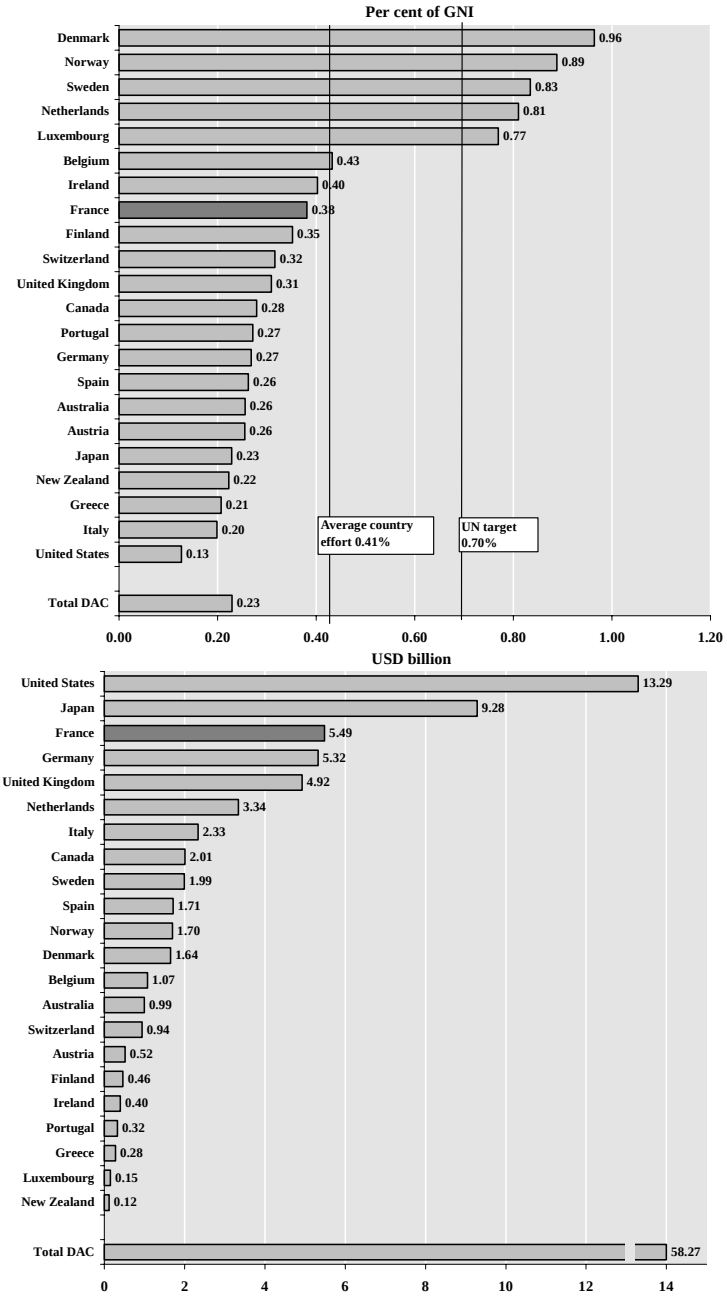
Notes:

a. Excluding debt reorganisation.
b. Including EC.
c. Excluding EC.
.. Data not available.

Source: OECD.

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Graph C.1. Net ODA from DAC countries in 2002



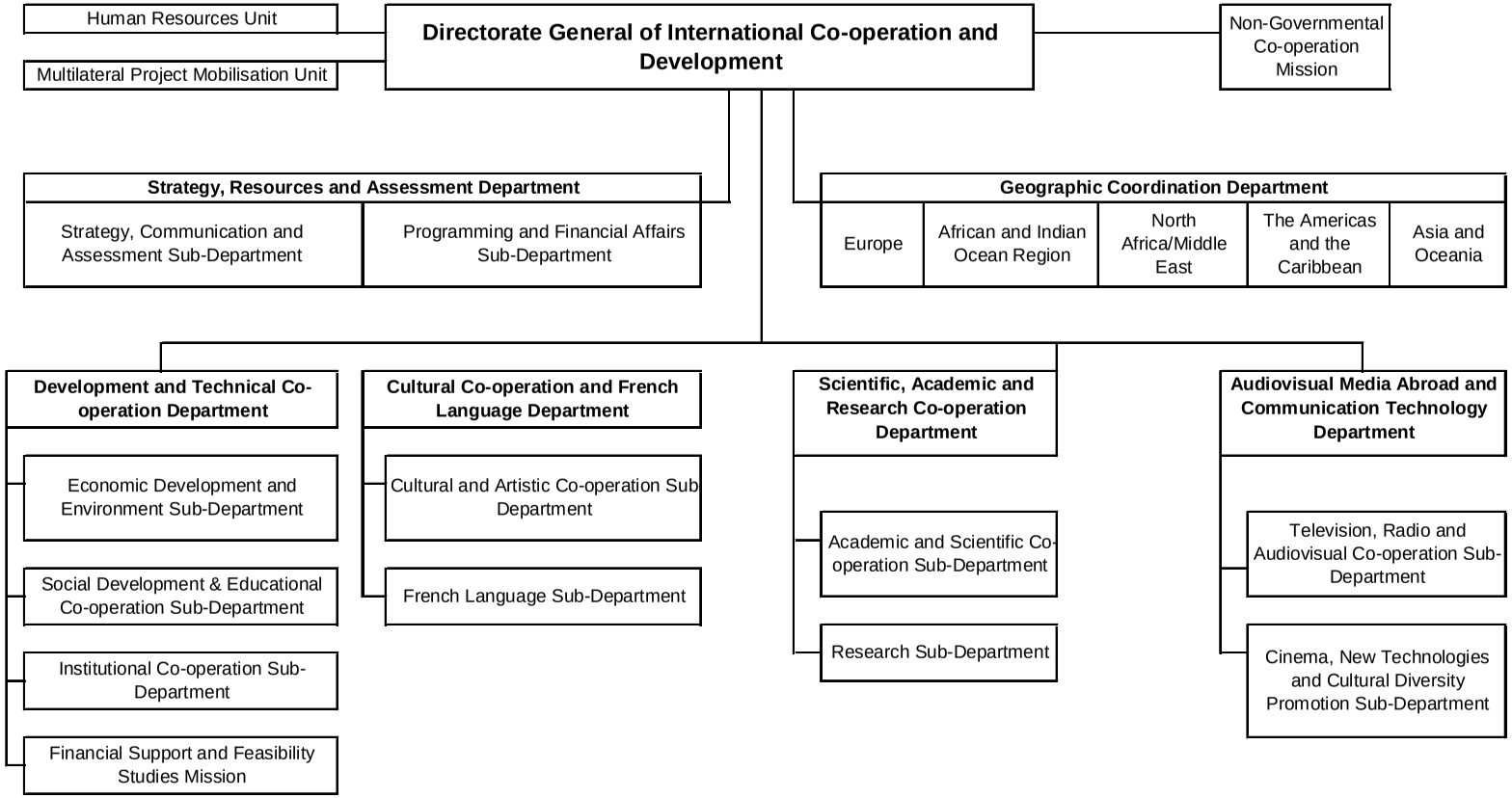
Source : OECD.

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ANNEX D

CHARTS

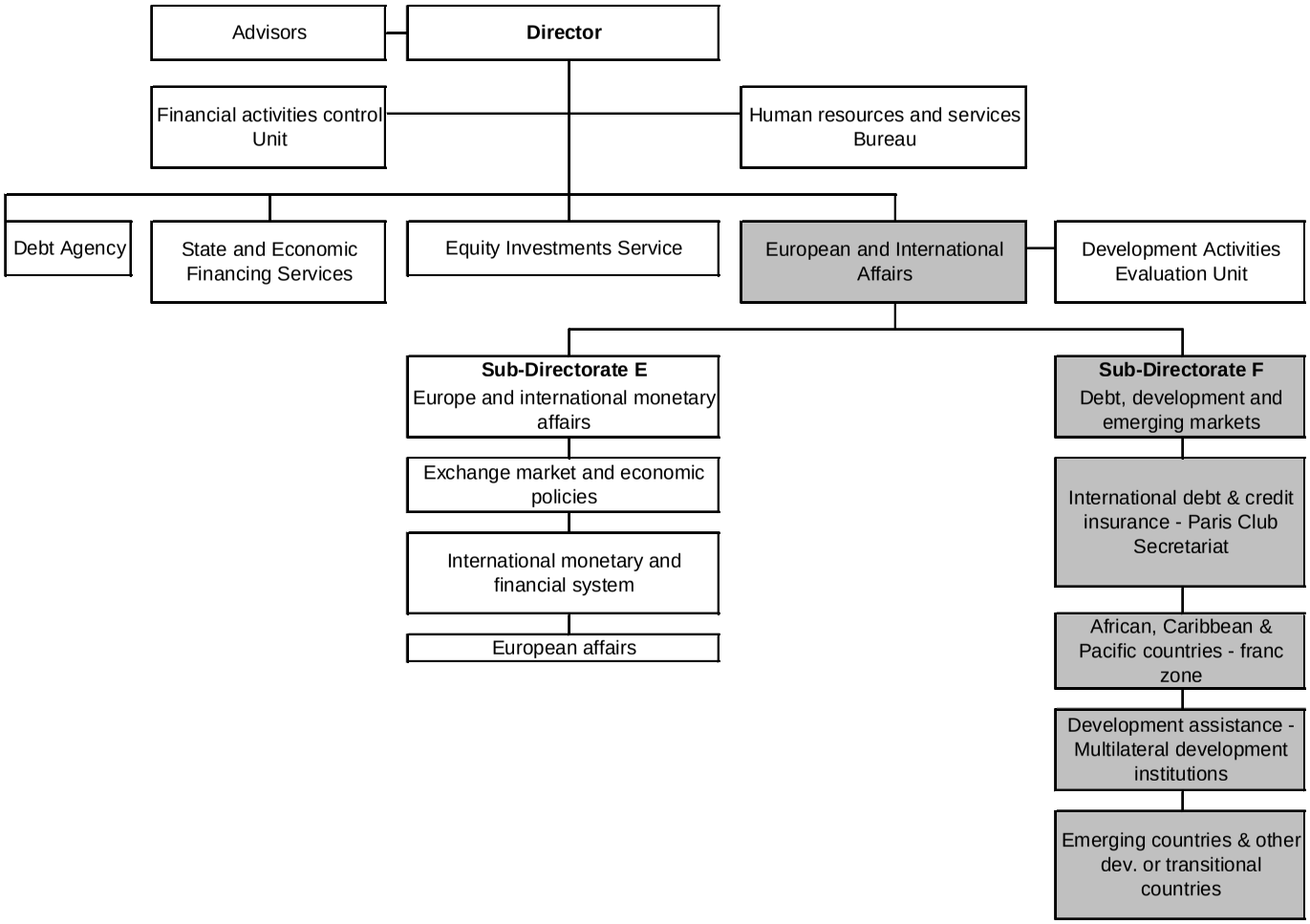
Chart D.1. MAE - Directorate General of International Co-operation and Development - DGCID



Source: MAE, March 2003.

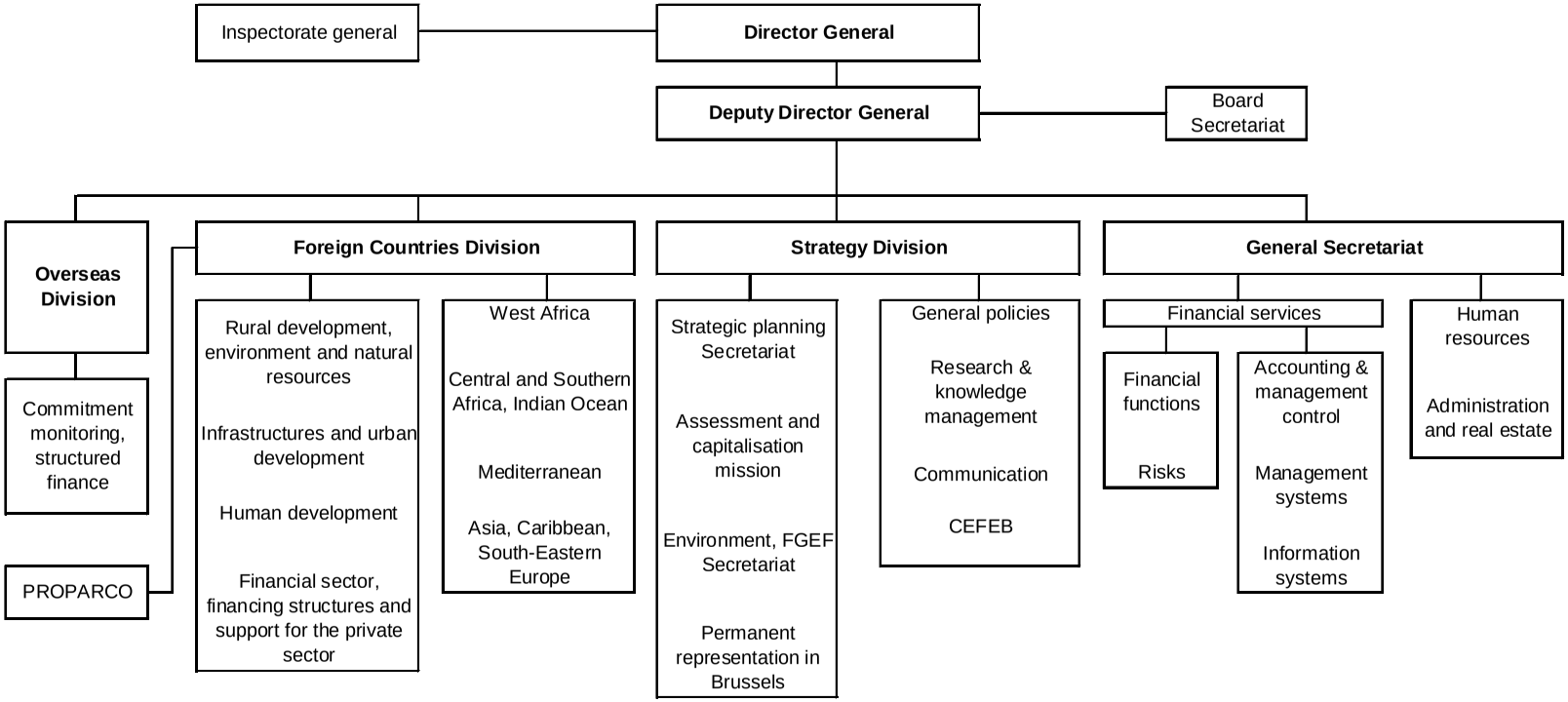
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Chart D.2. MINEFI - Treasury Directorate



Source: MINEFI, August 2003.

Chart D.3. Agence Française de Développement (AFD)



Source: AFD, September 2003.

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ANNEX E

FRANCE'S AID PROGRAMME IN BENIN

Introduction

As part of the review of French aid, a DAC mission made up of representatives from Canada, the Netherlands and the Secretariat visited Benin between 17 and 21 November 2003. It met with the main French co-operation officials, representatives of the Benin government and civil society and officials from bilateral and multilateral aid agencies. The present report reflects their understanding of France's system of aid to Benin and proposes some topics for reflection in the areas which seemed to them most crucial.

National context

Benin has a number of major assets that favour its development: an advantageous geographical position in West Africa; a stable political and macroeconomic situation; a system that respects human rights; and economic growth that has exceeded 5% for the last six years, while inflation has remained relatively low at around 3%.

Yet this broadly favourable environment masks weaknesses that are both political and economic. At political level, central government is dominated by the personality of the President, Mr. Matthieu Kérékou, who was re-elected for five years in 2001. The fact that there is no prime minister complicates trade-offs between the technical ministries and means that certain issues remain at a standstill. The Law on Decentralisation (2001), which took a long time to come into being, has still not provided the 77 communes with the human and financial resources needed for their development, while the local level networks restrict the scope of decisions taken by central government. Despite its undoubted dynamism, civil society suffers from a lack of credibility, the majority of officials being closely linked with the administrative and political elite. Lastly, corruption, which is rife in Benin, is accentuated by the clientelist links between actors from the private and public sectors.[19]

The 3.2% per year rate of growth of the population in recent years has not significantly reduced poverty in Benin, the country being ranked 158th out of 173 on the human development index (2000). In 2001, just 61.1% of the population had access to drinking water and the adult literacy rate was put at 48% for men and 25% for women. Surveys on poverty show that it has increased slightly in rural areas since 2000 and that it varies according to the *département* and the social group on one hand, and according to gender, household size, age and the level of education of the head of household on the other.[20]

19. T. Bierschenk, E. Thioléron and N. Bako-Arifar, *Institutionnaliser la stratégie de réduction de la pauvreté au Bénin*. Study commissioned by the Overseas Development Institute, London, July 2002.

20. Republic of Benin, *Premier rapport sur les objectifs du millénaire pour le développement, Ministère chargé du Plan, de la Prospective et du Développement et Système des Nations Unies*, Cotonou, July 2003.

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Benin is very dependent on foreign aid (EUR 298 million in 2000).[21] The level of mobilisation of domestic resources has long been one of the lowest in sub-Saharan Africa. The level of indebtedness (37.1% of GDP in 2001) was such that the government was able, in July 2000, to take advantage of the HIPC initiative. In March 2002 the Benin government produced a PRSP which seems, for the moment, to have been circulated only to certain government officials and foreign partners. Benin has also put together a parallel Action Programme (2001-2006) and subscribes to MDGs.

The *Premier rapport sur les objectifs du millénaire pour le développement*, prepared together with the UNDP, assesses the impact of poverty reduction strategies and makes it easier to implement them on the basis of the scheduled results. In order to better monitor trends in poverty in the framework of the PRSP, an *Observatoire pour le Changement Social* was set up in 2001 with the help of outside financing, but is not yet operational. The poverty debate is the subject of controversy in Benin, some people feeling that it should be combated by placing the emphasis on wealth-creating production sectors, infrastructure, human resources and good governance, instead of just the social sectors; also, these efforts have to be backed up by a development ethic that needs to focus on saving, investment and social solidarity.[22]

Benin's economic development is almost entirely dependent on frontier trade and marketable services. Cotton is the main cash crop (40% of GNP, 81% of exports and 75% of jobs,[23]) while manufacturing industry has to all intents and purposes not developed at all. Since the 'democratic renewal' (1990) the country has been attracting a growing number of development players (21 bilateral and multilateral agencies and a host of NGOs), but domestic and foreign private investment is still not forthcoming.

Characteristics of French co-operation in Benin

French co-operation in figures

According to the 2002 Report entitled *Coopération France-Bénin*, prepared by the French Embassy, French ODA disbursements in 2002 were broken down as follows in Table E 1.

Table E.1. French co-operation in figures (2002)

Instruments	EUR million	In %
Ministry of Foreign Affairs	**7.3**	28
• Priority Solidarity Fund (FSP)	1.8	8
• Social Development Fund (FSD)	0.7	2
• Technical assistance	3.2	12
• Education grants, missions and culture	1.16	4
• Budgetary aid	0.6	2
French Development Agency (AFD)	**9.3**	36
MINEFI (Debt relief)	**9.3**	36
Total	26	100

Source: Coopération France-Bénin 2002, French Embassy.

21. Republic of Benin. *Ministère chargé de la coordination de l'action gouvernmentale, de la prospective et du développement. Rapport 2001*, Cotonou, December 2002.

22. Opinions expressed by Beninese intellectuals during talks with the examiners.

23. Government of Benin. *Document stratégique de réduction de la pauvreté 2003-2005*. December 2003.

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The Report reveals that disbursements under the heading of the Priority Solidarity Fund (FSP), technical assistance and project aid implemented by the AFD have fallen since 2000. A total of 78 projects were in progress in 2002 (27 FSP projects, 30 Social Development Fund [FSD] projects and 12 AFD projects). Also according to the Report, France was the sixth biggest provider of ODA to Benin in 2001, behind the International Development Association (AID), the European Union, the African Development Fund (AfDF), China and Denmark.[24]

The statistics given below in Table E.2. compare the disbursements reported by the French Embassy in Benin and the amounts reported by the French authorities to the DAC.

Table E.2. Disbursements/Payments

Disbursements		Payments (DAC)
Year	**EUR million**	**USD million**
1998	28	37
1999	29	37
2000	32	85
2001	32	51
2002	26	49

Source: Co-opération France Bénin 2002, French Embassy and DAC.

The differences in ODA between the DAC figures and those provided by the French Embassy are explained by the Treasury's exchange rate guarantees deriving from France's monetary co-operation with the countries of the CFA Franc area.

A rich and varied system

It is the Ambassador's role to co-ordinate French co-operation in Benin. This consists of:

- The Co-operation and Cultural Action Service (SCAC), which is responsible for managing aid provided by the MAE. It comprises six French officials, one of whom heads the service, and an international volunteer. The SCAC's contacts are mainly with the ministries that have to do with its cultural, scientific and technical activities and, more recently, with civil society players in the framework of the FSD. The latter, which provides some EUR 1 million per year, helps to co-finance small projects with an immediate impact on the populations targeted.

  The SCAC is mainly involved with (i) strengthening the rule of law and consolidating democracy (decentralisation and devolution of public services, the functioning of institutions, strengthening the capacity of government, protection and safety of people and goods); and (ii) improving the functioning of the social services [support for education, occupational and technical training, health (quality and diversification of care, management of the health care system in hospitals, measures to combat HIV/AIDS) and local and urban development].

  The SCAC manages technical co-operation (38 assistants) and the education grants and training programmes provided by all the French ministries. High-level civil servants and technicians are seconded from different French technical ministries to ministries in Benin. Some technical assistants work as "advisers" backing up the SCAC and have an important role in the management of FSP-financed projects. They are also becoming increasingly

24. *Source*: *Ministère d'Etat chargé du Plan, de la Perspective et du Développement.*

involved with projects financed by other organisations (such as the World Bank). The FSP contributes to development in the form of grants towards multi-year projects and programmes in institutional, social and cultural development and also research.

- The AFD, which has fewer than two officials – its representative in Cotonou also covering Togo – and two international volunteers. The AFD operates via project aid, with the Benin side running the projects. Although depending on its head office in Paris, it does enjoy some decision-making and management autonomy. The Agency provides subsidies (grants) and non-sovereign loans for infrastructure and basic utilities in urban areas, for the transport sector, for rural development and for ecotourism (conservation and management of national parks, with a contribution from the *Fonds Français pour l'Environnement Mondial*). It also has a *Fonds d'études et de préparation des projets.* Having initially focused mainly on income-generating activities, the Agency is intending to concentrate its subsidies on rural and urban development, and also a new sector – basic education – which will supplement a FSP project now being set up.
- A *Mission de coopération militaire et de défense*, with a team including a defence attaché paid for by the MAE and some thirty *coopérants*. Military co-operation takes the form of direct aid, technical assistance and training for defence forces. Disbursements amounted to some EUR 4.55 million in 2002.
- A *Service de coopération technique international de la police* (SCTIP) headed by an internal security attaché flanked by two technical advisers.
- A *Mission économique* attached to the Directorate for External Economic Relations (DREE) whose staff are the contacts for French firms.
- The French Cultural Centre, which was set up in Benin in 1967.
- The Lycée Montaigne, which has been in operation since 1975 and comes under the heading of the cultural co-operation agreement signed between the two governments.

The list also includes numerous other players from the public and private sectors, the world of research and community bodies:

- Decentralised co-operation bodies (regional councils and municipalities), which act independently and have their own funding but also receive MAE funding (some EUR 432 000 in 2002).
- French NGOs, 17 of which are represented in Benin. Most of these NGOs cofinance projects eligible for the FSD and/or receive subsidies (EUR 577 000 in 2002) for implementing programmes submitted to the MAE's NGO Committee.
- Public establishments (*Institut de la recherche pour le développement* [IRD], *Centre de coopération internationale en recherche agronomique pour le développement* [CIRAD]), dependent on technical ministries which, compared with the French government's co-operation system, have the human resources and budgetary independence.

Co-operation based on tradition

France is very much present in the economic and cultural life of Benin. It differs from the other countries providing co-operation by virtue of the weight of tradition based on the historical and cultural ties for a long time enjoyed by the elite who make up Benin's public administration which is now in need of renewal. Relations between the two countries have acquired a new dimension in recent

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years as a result of the exchanges between civil society actors, including in the framework of decentralised co-operation which today is expanding rapidly. The longstanding relations between France and Benin have created affinities between individuals and authorities, but are now being challenged by a new generation which is less attached to some of their predecessors' achievements. Lastly, France is a privileged but no longer the sole partner in bilateral relations, other foreign aid donors having come on the scene, as the new team in place in Benin is very well aware.

Policy objectives promoting development

In the note on the thrust of French co-operation contained in the country strategy paper (DSP in the process of being ratified by CICID), France sets itself two targets in Benin: (i) to influence the national authorities' strategic choices regarding development; and (ii) to increase the impact of both its actions and those of its partners in implementing the DRSP.[25] With these targets in mind, France's strategy is to strengthen the capacity of central and general government and civil society by means of technical assistance, which needs to be strategically targeted on key sectors, and more suitable financial instruments. It is also the intention to improve the linkage between French co-operation and that of other partners in the context of the DSRP and the programme approach, at the same time bringing the focus back to bear on sectors in which it has a comparative advantage (strengthening the rule of law and consolidating democracy, improving the functioning of the social services and backing economic development). As before, it is anxious to establish or maintain its influence by helping to train the country's future elite. The DSP was drafted internally, without any upstream input from the Benin side or other donors, and is in principle due to be circulated within the French administration.

Overall assessment

A co-operation strategy geared to gaining influence

The guideline paper defines French development strategy in terms of a quest for influence at different levels. In theory, educating the elite classes and exerting influence on decision-makers in the Benin Government ("top-down" influence) is not incompatible with measures taken at user level ("bottom-up" influence) as long as the final outcome is a reduction in poverty and inequality. Not having found any explicit reference to the MDGs, the mission wondered about the link between, on one hand, the declared objectives and the reduction of poverty and inequalities and, on the other, between what is envisaged for French co-operation in Benin and what the other partners represented in the country are considering. Also, the strategy of gaining influence, which involves being everywhere at once, might seem to be at odds with the concern of the French authorities to enhance aid effectiveness in Benin by better defining their priorities. For both the examiners and the majority of those with whom they were in contact, the strategy as presented lessens the clarity of French action and gives the impression that it is governed more by aid instruments and modalities than by a vision of development extending beyond purely political considerations. The new team is thinking about these questions and proposes in future to align itself on the PRSP priorities and endeavour to ensure that French co-operation is consistent with that of other donors.

A composite set of actors, instruments and modalities

French co-operation in Benin embraces a broad range of activities involving a host of players, instruments and modalities. It is a scenario which is not confined to Benin and which for a long time reflected a more global strategy, namely that of strengthening France's position in French-speaking

25. Extract from the country strategy paper in the process of being ratified, which was given confidentially to the examiners in Cotonou during the course of their mission in November 2003.

Africa. It has helped to enhance understanding of the surroundings, to form links between development players and to adapt aid to the changing state of the country. France's presence in a great many sectors also reflects the authorities' difficulty in resisting the demands of ministries and other bodies in Benin that France should be involved in all areas. Compared with those of other agencies, which focus more on a few key areas, the activities of French co-operation are not very obvious to the people that the mission met and talked to. Some of these activities, especially in the institutional area (support for the justice system, for public finance, for the media and producer organisations), are not really visible to the people of Benin, even though much has been achieved. The lack of visibility of French action is, it would seem, accentuated by the lack of a strategic "vision" capable of conveying the French position in relation to Benin's major development challenges.

Efforts to consult and co-ordinate from within

The mission considered how the more or less independent actors could be brought together to work towards the objectives of French co-operation, and wondered whether there was not a risk of divisions arising between them and the various areas in which action was being taken. In this respect, it seemed that consultations between the main bodies responsible for French action (the SCAC and the AFD) did function. This, in the opinion of the mission, was a positive factor which could help to improve synergies between the different types of activity. With regard to applied research, for example, certain activities fit in well with development programmes (in the areas of hydraulics/health and the cotton/food crops linkage in particular). With regard to the programme to strengthen African peace-keeping capabilities at sub-regional level, the humanitarian aspects are linked to training in institutional law and conflict management. Then again, where strengthening the capacities of general government are concerned, schemes to bolster justice, security and human rights appear to be complementary. The whole appears to be effectively co-ordinated under the responsibility of the Ambassador, and there is the prospect of involving players from civil society and decentralised co-operation to an increasing degree.

Notwithstanding the efforts to ensure complementarity between sectors and players, the dangers of MAE activities encroaching on those of the AFD do exist, particularly in education and social development. Against a background of increased dialogue with partners in Benin and other donors and reduced staff numbers, for both institutions to keep up their commitments in the same areas could prove costly in terms of resources and the expertise needed for follow-up purposes. The question will become more pressing if recourse is had to the programme approach in education, since there would no longer be any need to make a distinction between financing for institutional back-up and for infrastructure purposes.

Technical assistance set to evolve

One of the main instruments of French strategy is technical assistance (TA), which has a "… major role to play in the conception, definition and implementation of the sectoral strategies laid down by the PRSP.[26]" In the mission's opinion, that position raises the problem of ownership and follow-up. TA is a specific feature of French co-operation and one of the MAE's key instruments. The number of technical assistants has diminished appreciably over the past ten years and, according to the SCAC, the aims have also changed, the emphasis now being on short and medium-term missions – depending on demand, incorporating assistance in projects and programmes and making training central to French action. To quote the Ambassador in Benin, the mission of technical assitants is "destined to disappear" in time.

26. *Orientations de la coopération française*, document circulated informally to the examiners.

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The mission acknowledges that French TA is better linked with projects and programmes than in the past and that it does serve strategic ends, often at the request of Benin's decision-makers or of other partners. Its impact on the strengthening of capacity and on ownership can be perceptible at local level (see Box E.1), but it is less visible and harder to measure in the context of support for decision-makers in sectoral ministries. The team in the field recognized that partnership and ownership were problematic with the Benin government, but were more rewarding with civil society and local authorities.

Consultations with Benin and outside partners confirm that using TA is not always synonymous with increasing capacity, unless this is one of the specific aims of the programmes of which it is part, and that nationals do not systematically take over. Also, this form of assistance is expensive and inclines more towards bilateral relations, with the result that it is rarely transparent. Generally speaking, TA may be perceived as a criticism of the competence of nationals, and the question of its continuity once it stops can arise.

Box E.1. Programme for the Professionalisation of Agriculture in Benin

In strengthening producer organisations' capacities in terms of analysis, diagnosis, selection, proposals and implementation, France helps the said organisations with the preparation of their professional projects. French co-operation in particular assists:

- Those in charge of such organisations with the establishment of a professional project or partnership with credit institutions, public and private operators and public services.
- With access to information think-tanks, joint visits and diagnoses, analyses and reconstruction, the preparation of survey agreements and actions plans.

All the activities are conducted by those in charge of the producer organisations and their paid technicians, and the programme provides technical and methodological back up. Where all the activities are concerned, the programme endeavours to expand the references of farmers' leaders, whether in Benin or in the sub region, or with French producers organisations' officials. The involvement of *Agriculteurs Français et Développement International*, which is one of the programme's most important partners, is of great assistance in organising these farmer exchanges.

Extract from a note introducing the Programme for the Professionalisation of Agriculture in Benin (PPAB), which was given to the examiners on 16 November 2003.

Energizing relations between France and Benin

It is difficult for the mission to reach a conclusion about the dialogue between French co-operation and its Benin partners, other than to say that it could well be compartmentalised according to who is the interlocutor. Consultations seem to be effective between the ministries the mission met with and the technical assistants working for the ministries to which they are attached. During field trips, the mission found that relations between Beninese and French actors at the micro level also seemed to be good and conducive to project implementation (for example, the project for the improvement and diversification of farming systems). In 1997, the French authorities had involved NGOs - Beninese too - in the final joint commission. The mission noted the strong feeling that the French authorities needed to be more in touch in the commissions. The need to improve collaboration between French and Beninese NGOs was also clearly expressed. The team now in place informed the mission of its intention to give fresh impetus to Franco-Beninese relations at the next joint commission in 2004.

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High transaction costs

The work involved in project management appears to have grown for the SCAC and the AFD in recent years as a result of the increased number of schemes and the decline in staff. Also, the differences in the procedures used by the bodies involved in French co-operation, plus the relatively large number of projects (78), result in transaction costs on both the French and also the Beninese side. The mission was told that the merging of the MAE with the Ministry for Co-operation had generated real costs for the SCAC. It now has to comply with the complex procedures of the MAE whose upstream and downstream demands are holding up project implementation. It would appear that, prior to the reform of co-operation, AFD procedures were used more efficiently. The mission was also informed that technical assistants had persistent cash-flow problems, which lessened the effectiveness of their activities.

Making better use of available information

The mission noted that the AFD and the SCAC had a system for keeping a regular check on the projects that they financed. It did not have an opportunity to ask about the approach used by the NGOs and decentralised co-operation. The AFD produces biennial and end-of-project reports and had, it would seem, undertaken to define indicators at the implementation stage. A few assessments are made at sectoral level from head office, by means of calls for tender.

Where the SCAC is concerned, technical assistants have a brief and send an annual report on their activities to the MAE. Measuring or performance instruments designed to gain a better idea of the effectiveness of their activities and assess their impact do not appear to have been developed. All FSP projects are assessed at headquarters. Under a service provision agreement the AFVP, which is the biggest French NGO in Benin, monitors and keeps track of the entire FSD budget envelope. Whether with regard to the AFD or the SCAC, little or no information is circulated.

Co-ordination with other partners could be improved

Co-ordination between donors, including France, suffers from the Beninese authorities' lack of eagerness to assume this responsibility and from a real lack of leadership, except in a limited number of areas such as HIV/AIDS or the group on Participatory Development and Good Governance (PD/GG.[27]) The Thematic Group on AIDS, chaired by the UNDP, is a successful example of co-ordination between donors, national structures for combating HIV/AIDS and NGOs. France, which demonstrated its commitment in this area by being the first donor to monitor patients hit by the disease, serves as vice-chair of the Group.

According to *Co-opération France-Bénin*, French co-operation works closely with German co-operation in the framework of the decentralisation and management of natural resources. The SCAC and AFD are in very frequent contact with the IFIs with which they collaborate in a great many areas (public finance, decentralisation, urban management, the cotton industry). There are also consultations with other bilateral agents, United Nations bodies and the European Union (though they are less effective in this latter case according to the team in place) on areas of convergence (rural tracks and justice in particular). The linkages between the activities of the various partners of the Beninese Government have hitherto been hampered by (i) the variety of contact points in ministries

27. Participatory Development and Good Governance – a mechanism set up in 1998 by the OECD Development Assistance Committee to encourage donors to act together to promote good governance and sound management of public affairs in a number of pilot countries, including Benin.

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and (ii) the differing procedures used by bilateral and multilateral donors. This is in the process of changing as a result of the adoption of the programme approach and budgetary support.

In the opinion of those spoken to, France differs from other donors by virtue of its influence-oriented strategy and could be more active (in terms of initiatives and proposals) in the thematic groups. Links with bilateral and multilateral donors is one of the topics that could be the subject of a debate at the next joint commission.

Items to bear in mind

Reframing and rethinking French action

France could take advantage of the next joint commission in 2004 to rethink its action in Benin, not only on the basis of its influence-oriented strategy, but also on that of Benin's role in regional integration, the aspirations of France's partners in Benin and the measures taken by other donors. The mission noted the interval between the last joint commission and the next (seven years) and wondered how useful this sort of mechanism is, now that the PRSP is the reference framework for all partners, with its implementation scheduled to be monitored on an annual basis. The opportunity should be taken at the next joint commission to think about these questions and build in the new components which are the PRSP and the decentralisation process. It is a matter, *inter alia*, of finding a balance between the different levels of operation (macro and micro) at which France expects to generate the greatest measurable impact and the different players (state and non-state) involved in co-operation.

The connection between the aims of influencing development at the top and combating poverty and inequality could be clarified and the concept of partnership better defined in the context of project implementation. The "gender" dimension, which is lacking in policies, needs to be better integrated upstream of projects, with use perhaps being made of the AFD's study and project preparation funds. Even if some projects are aimed specifically at women – *e.g.* the support project for the promotion of women, driven by the *Union des Productions du Sud Bénin* – the mission noted that the lack of thought given to prospects undermined the credibility of certain schemes. As a general rule, technical analyses ought to be backed by more refined analyses (sociological and/or gender) which would make it easier to select projects on the basis of their foreseeable impact on the different social groups. The programme approach and jointly financed projects should make it easier for donors to pool resources in order to finance this type of analysis.

The examiners found that the new French co-operation team was open to change and ready to rethink certain aspects of it out of a desire to be effective and in order to come into line with the PRSP. While not perfect, it is a document that gives all donors a reference framework. Its implementation unfortunately suffers from the sluggishness of co-ordination within the Beninese government and by the rivalry between ministries. However, that situation cannot last for ever and ought not to prevent donors from co-ordinating their efforts. In this connection, France could work towards ensuring that the PD/GG adapts to the needs of co-operation which emerged with the existence of the PRSP. The sectoral programmes and budgetary support also provide an implementation framework that is already used by a number of Benin's donors (Denmark, the European Union, Switzerland, the Netherlands, the World Bank and the African Development Bank). Despite being a major practitioner of project aid, France does use programme aid in certain areas (village water systems, for example, together with Danish and German co-operation, and basic education in the context of the Fast Track Initiative) and has decided to implement budgetary support in the framework of the PRSP.

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To meet the need for French co-operation in Benin to be consistent and effective, the team in place could focus on a few key sectors or themes where it has added value. It could clarify the roles of the main participants in these activities on the basis of the development outcomes targeted more than the actors involved. Consideration could also be given to harmonising the ways in which each programme or project involving both the SCAC and the AFD are followed up and monitored, and to the preparation of results indicators to be used by France and Benin. Reducing the number of projects would lower management costs, increase their impact, make them more complementary and increase exchanges of experience. Lastly, co-ordination with other partners should be improved by refocusing French co-operation and financing the programme approach.

The mission was informed that a few major types of activity had been pre-selected by the team in place. These included the decentralisation and devolution of government services, support for the basic social services and aid for the cotton sector and the diversification of the industry. There would have to be trade-offs on the basis of (i) consultations between partners, (ii) the potential for ownership by the Beninese and (iii) the potential for complementarity with the activities of other bilateral and multilateral donors.

Ensuring continuity and ownership

The mission believes TA to be a good instrument as long as it is used in a circumspect and transparent manner. In this, as in other areas, opportunities exist for donors to pool resources and better use could be made of them – in the context, for example, of the implementation of the PRSP and sectoral strategies. One of the main problems in Benin is not any lack of expertise, but how to identify, catalogue and utilise the potential of the Beninese and local-level organisations. Setting up an incubator on the basis of a catalogue drawn up at national and/or regional level could partly meet this need, and would in fact follow the example of certain donors who have established a human resources data base. Another possibility would be to make use of NGOs (of any origin) for tasks not involving any great technical competence. These actors, who are close to the users, are better able to generate synergies with their own activities. In the longer term, serious consideration should be given to replacing technical assistants with Beninese nationals.

At all events, TA should be provided on the basis of needs identified by partners for each sector or area of activity. Its impact, gauged in relation to the objectives of the project or programme, ought also to be assessed jointly with the partners concerned. Right from the start of a project, it is important to make provision for its withdrawal and to see it as a means of reinforcing the local teams which will be called upon gradually to take over responsibility for project management. The training projects driven by the MAE, which are supposed to provide training for trainers, should enable the Beninese to take over, and the same is true of the schemes targeting agriculture and research; here too, the mission noted the competence of the Beninese teams.

Measuring the impact

Generally speaking, even if follow-up and monitoring procedures are well established in the machinery of French co-operation, impact measurement systems and mechanisms for turning the achievements of completed projects to account have still to be devised. For the majority of donors, this is still a neglected area and one which ought to be the subject of increased attention as part of the follow-up to the MDGs in particular. The mission noted that when urban markets were being built, the AFD was concerned not just with health questions, but also with the results in terms of the number of economic activities generated. The analysis needs to be taken further, with changes in the incomes of the populations concerned being measured, for example. The Beninese government, which is in the process of setting up units to monitor budget implementation, is planning to draw up impact appraisal

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criteria for a number of sectors. For this, the Beninese administration's statistical skills would need to be strengthened. The system ought ultimately to concern all donors practicing budgetary aid and the programme or sectoral approach.

Better communication

France's co-operation strategy in Benin is a lot less explicit than others concerning the major challenges of development. That said, many projects are involved with combating poverty, whether in the areas of rural water supplies and health or in the context of support for productive activities. An active communication strategy aimed at all partners could be devised with a view to raising the profile of French action in Benin, making the logic behind the projects clearer and highlighting those involving poverty reduction, partnership, sustainable development, etc. It could take the form of periodic information bulletins summarizing French action and/or project notes. The French system would also gain by ensuring that more is known about its co-operation programme in Benin, beginning with the DSP.

Conclusion

The background to French co-operation in Benin is complex from the point of view of Benin's institutional and political reality, but also conducive to change for donors as a whole. French co-operation has many advantages, stemming from its lengthy involvement with aid and its understanding of Benin's administrative culture which it has itself helped to shape. Over the years, co-operation has been strengthened thanks to a system which is rich and varied from the point of view of both the actors involved and the instruments and methods employed. The system now needs to be updated so that it can cope with the major challenges of development and meet the need for effective French aid.

The examiners hope to have prompted French co-operation in Benin to focus on a number of key areas. Their recommendations concern four important points: the consistency of the system, taking over and ownership, impact measurement and communication aimed at increased visibility. The team in place in Cotonou seems to want to take a fresh look at co-operation and could take advantage of the next joint commission to review certain aspects of it in a spirit of partnership.

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ANNEX F

FRANCE'S AID PROGRAMME IN MAURITANIA

Introduction

As part of the review of French aid, a DAC mission made up of representatives from Canada, the Netherlands and the Secretariat visited Mauritania between 17 and 22 January 2004. It met with the main French co-operation officials, representatives of the Mauritanian government and civil society and officials from bilateral and multilateral aid agencies. The present report reflects their understanding of France's system of aid to Mauritania and proposes some topics for reflection in the areas which seemed to them most crucial.

To support Mauritania's development process, France has designed a co-operation programme that is intended to be innovative and of high quality. Although France is an important donor, it no longer plays a leading role given the multilateralisation of aid.[28] Its annual contribution accounts for 25% of bilateral aid to Mauritania and less than 10% of total ODA. Gross disbursements have levelled off at approximately USD 24 million, having fallen by over 50% from their level in the first half of the 1990s. In the coming years, ODA should be divided between technical co-operation (40-50%), debt reduction/development contracts (C2Ds) (15-20%), the AFD (15-20%) and the FSP (15-20%).[29] Complementing French co-operation in Mauritania are the decentralised co-operation initiatives (27 twinnings of towns and two of regions) and the initiatives of some ten international solidarity organisations, some of which receive co-financing from the French government.

The DSP constitutes the strategic reference framework for the entire French development co-operation programme in Mauritania. Most activities contribute directly to the realisation of the MDGs. The poverty reduction objective, which is a major aim of French co-operation in Mauritania, was reaffirmed with the implementation of a C2D in 2003. The resources provided – EUR 14.7 million over three years – are allocated in the form of budgetary aid, with two-thirds going to the National Programme for the Development of the Education Sector (PNDSE) (see Box 8 in Chapter 6) and one-third to poverty reduction programmes in two of the country's most disadvantaged regions. France is also supporting the process of transition to budgetary aid by providing technical assistance for the preparation and implementation of the state budget, in close co-operation with theIMF, the World Bank and the European Commission.

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28. With gross ODA of USD 24 million in 2001-02, France was the biggest bilateral donor, after the EC (130 million) and the World Bank (49 million). However, the EC's amount includes an annual contribution of USD 89 million under the International Fishery Agreement, despite the commercial nature of this transaction. Mauritania ranks second among France's ODA recipients.

29. Debt relief currently accounts for a significant share of French ODA to Mauritania (23% in 2002). Technical co-operation includes the costs of Mauritanian students attending French universities (15% of French ODA in 2002).

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The reduction in resources and the wish to improve effectiveness had prompted the French authorities to undertake a major shift in focus during the preparation of the DSP in 2001. In the field of support for the economy and sustainable development, emphasis was placed on infrastructure and small-scale fisheries. In the productive sectors (agriculture, fisheries and mining), there was a move towards natural resource management. In the social sectors, priority was given to the reform of primary education, water resources and rural electrification and urban development. Noting the lack of impact of support for institutions, France decided to concentrate on backing decentralisation and deconcentration aimed at promoting greater democracy at the local level.

France has shown flexibility and adaptability with respect to the changes under way and is taking the country's context and needs better into account. The United Nations' report on the progress made in achieving MDGs has pointed out that the health field is lagging well behind. France, after moving away from the health sector, which it considered to be over-funded while producing poor results, has formed a technical assistance team to explore with the World Bank the possibilities of implementing a programme-based approach and giving fresh impetus to the health thematic group. France will decide what financial support it provides under this approach on the basis of needs.

As it engages in the reflection process involved in preparing the next Joint Commission in 2004 and updating its DSP, France might take into account the following points:

(i) Strategy, programming and partnerships

Franco-Mauritanian dialogue would stand to gain from greater openness and transparency. The French authorities should consider involving their Mauritanian partners in the preparation of the next DSP. The role of the Joint Commission, which has not been convened since 1998, should be reviewed. The advantage of the Commission is that it can take stock of bilateral relations as a whole. However, despite its imperfections, the PRSP provides a more appropriate and dynamic framework for the annual comprehensive and sectoral monitoring of the actions of all donors. French co-operation should ensure co-ordination between this mechanism, the DSP and the Joint Commission.

In the next DSP, France intends to emphasise two strategic avenues: (i) democracy and the French language; and (ii) sustainable development and access to basic services. In this regard, it might give greater consideration, in co-operation with other donors, to how good governance might be more explicitly included in the dialogue with the Mauritanian government. It might also promote democracy as such more directly at the local level through its support for decentralisation and deconcentration. At present, this support primarily emphasises the organisation of communal services and participatory planning. France is encouraged to continue its efforts to strengthen civil society and participatory approaches.

In 1999, Mauritania opted to return to bilingual education (Arabic and French), which is considered to be a fundamental factor for its political and ethnic unity and its integration into economic networks at the regional and global levels. France is supporting this choice through initiatives in the field of the French language, one of the main objectives of which is to increase the use of French, which the present authorities see as providing "access to the world". Despite the merits of these objectives, it seems legitimate to ask whether making the use of French a strategic aim of France's development programme is a relevant choice. If Mauritania is to be more fully integrated into the globalisation process, knowledge of other languages, such as Spanish and English, might also be necessary. In the field of education, the main concern should be to strengthen the system, whatever the languages used.

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Country programming should be specific regarding the amount of resources made available to Mauritania. A block appropriation should be scheduled to promote multi-year programming compatible with the Mauritanian government's budget cycle. The uncertainty over the renewal of the C2D in 2006 will prompt growing concern about the predictability and maintenance of the level of French ODA. France should review the possible need for greater sectoral selectivity. Except for the concentration on education, French co-operation includes a wide range of activities involving at least ten very different fields. Greater sectoral concentration would give it a sufficient critical mass in certain sectors to have a greater influence and impact. For the AFD, this approach is consistent with the spirit of its Strategic Plan, which requires it to focus its action on a limited number of sectors in second-priority countries, of which Mauritania is one.

The PRSP appears to have promoted a good spirit of co-operation and task sharing between donors and seems to reflect a strong sense of ownership on the part of the Mauritanian authorities. Further progress is still necessary for the Mauritanian government to establish an ongoing process of co-operation that is both transparent and operational, especially at the sectoral level. The follow-up to the PRSP also requires a dialogue on public finance management which tends to be monopolised by the Bretton Woods Institutions. Outside the existing sectoral programmes, donors still have much progress to make in the adoption of common approaches, harmonisation and alignment of procedures. France is actively participating in the co-ordination process, particularly in the fields of education, decentralisation and water resources. Given its high-level commitment in favour of the Rome Declaration on Harmonisation, it could do more to promote implementation in the field.

(ii) Implementation

The situation in Mauritania shows that there is effective co-ordination between the *Service de Co-opération et d'Action Culturelle* (SCAC) and the AFD, which has led their respective activities to become more complementary. Synergies are evident in the fields of education, support for decentralisation and urban development. Maintaining two different agencies, each with its own team and different expertise and its own management systems, entails a significant cost, especially given the size of the programme. With regard to FSP projects, greater delegation of responsibility for implementation to national operators, as is already happening for certain activities in fisheries, would enable the SCAC team to devote more time to strategic analysis and monitoring management. In this regard, some Mauritanian partners have criticised the scant information provided to them by SCAC on the financial status of projects and the use of resources. The latter is aware of the lack of transparency in the management of the scholarships and grants programme and is planning to introduce a new resource allocation system.

The amount of technical assistance provided in Mauritania is relatively high – some 60 people, accounting for between 25% and 30% of ODA to Mauritania, half of which is concentrated in the education sector. An assessment should be made of the opportunity cost of this form of assistance which, despite its quality, remains expensive. The French authorities should ensure that it is more systematically adapted to the projects it is intended to support and explore the possibilities of mobilising expertise at regional level. Given the fungibility of resources to be introduced with the implementation of the LOLF, starting in 2006, the French authorities will have to make trade-offs which could result in a mix of instruments different to that of today. The relative effectiveness and impact of different approaches will therefore have to be analysed in relation to the capacity-building objective.

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(iii) Consistency of development policies

France has long provided support for the entire fisheries sector in Mauritania, which accounts for 50% of the country's export earnings. Given its experience in this field, France should be in a strong position to promote the interests of developing countries in the current process of reform of the European Union's fisheries policy, and to use what it has learned from its co-operation experience in Mauritania and elsewhere in its decision-making with respect to European fisheries policy (see section on fishery in Chapter 4).

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PRESS RELEASE OF THE DAC PEER REVIEW OF FRANCE

IMPROVING THE AID EFFECTIVENESS OF EUROPE'S LARGEST DONOR COUNTRY

The OECD Development Assistance Committee's (DAC) review of French aid policies and programmes commended the rise in the volume of French official development assistance (ODA) to USD 7.3 billion, or 0.41% of gross national income (GNI), in 2003 from USD 4.2 billion, or 0.32% of GNI, in 2001. France is the most generous G7 country in terms of ODA/GNI ratio.

France has pledged to increase its official development assistance (ODA) to 0.5% of GNI by 2007, equivalent to around USD 9 billion, and then to 0.7% by 2012, with at least half of the money going to Africa to help achieve the Millennium Development Goals (MDGs).

However, in the course of the review presided by DAC Chair Richard Manning on 26 May 2004, it became apparent that this will not be a straightforward task, given the government's current budgetary constraints. In addition, most of the ODA increase derives from debt relief for heavily indebted poor countries. This debt relief will peak in the near future, at which point the French government will have to continue to increase its official development assistance while at the same time mobilising additional budgetary resources to compensate for the gradual reduction of the debt relief effort. It would be in the interests of the French authorities to make provision now for a multi-year planning process and to adjust their instruments and the management of their human resources so that they can meet the challenge of overseeing this major growth in ODA.

French aid is guided by a number of key principles: priority to Africa; global public goods and the regulation of globalisation; sustainable development and democratic governance; cultural diversity and La Francophonie. The task of managing this aid is divided between three bodies, each with its own distinctive characteristics: the Ministry of Foreign Affairs; the Ministry of Economic Affairs, Finance and Industry; and the operator for these two ministries, the French Development Agency. This can lead to duplication in Paris as well as in the field and requires a greater co-ordination effort.

The DAC recommends that France issue a policy statement that sets out strategic directions for the entire co-operation system, on the basis of MDGs, and French support for the New Partnership for Africa's Development (NEPAD), and that makes reference to the national poverty reduction strategies of partner countries. Such a statement, combined with a multi-year planning process to set out goals and associated performance indicators, geographical and sectoral priorities, implementation and task-assignment procedures, would help make French ODA more transparent, strategic and effective. It would also help to raise public awareness and attract support from civil society. This approach would be consistent with implementation of the LOLF (Institutional Act on Finance Legislation), which provides for the drafting of a cross-cutting policy document for interministerial missions by as early as 2005.

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France plays a leading role in international efforts to harmonise aid procedures and practices. In 2005, France will host the follow-up meeting to the high-level forum held in Rome in 2003. The implementation of principles aimed at facilitating aid management in developing countries is still at a very early stage. The DAC invites France to adopt a more active approach towards implementation and encourages the French authorities to pursue the work of adjusting the instruments and procedures used for French co-operation to make them more effective, especially at the field level.

Seeking to promote fairer and more democratic globalisation, France has made a commitment to secure the better integration of African countries into the world economy. In this respect, France was a major force behind the European Union plan to create fairer trading conditions for African cotton producing countries. France's action in this area could be expanded to the pursuit of reforms which would assist developing countries' exports in sectors where they have a comparative advantage. To ensure that the interests of developing countries are taken into account more systematically in decisions taken by the French government, the DAC recommends that the French government make policy coherence for development a more explicit goal and that the government strengthen interministerial co-ordination mechanisms in this respect.

The French Delegation was led by Mme Odile Renaud-Basso, Head of the European and International Affairs Service in the Treasury Directorate (Ministry of Economic Affairs, Finance and Industry). The countries designated as examiners for the peer review of France's development co-operation policies and programmes were Canada and the Netherlands. A member of the Executive Secretariat of NEPAD was invited by the French government to take part in this exercise.

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DESCRIPTION OF KEY TERMS

The following brief descriptions of the main development co-operation terms used in this publication are provided for general background information.

ASSOCIATED FINANCING: The combination of official development assistance, whether grants or loans, with other official or private funding to form finance packages.

AVERAGE COUNTRY EFFORT: The unweighted average ODA/GNI ratio of DAC members, i.e. the average of the ratios themselves, not the ratio of total ODA to total GNI (cf. ODA/GNI ratio).

DAC (DEVELOPMENT ASSISTANCE COMMITTEE): The committee of the OECD which deals with development co-operation matters. A description of its aims and a list of its members are given at the front of this volume.

DAC LIST OF AID RECIPIENTS: The DAC uses a two-part List of Aid Recipients which it revises from time to time. Part I of the List comprises developing countries (eligible to receive official development assistance). It is presented in the following categories (the word "countries" includes territories):

LDCs: Least Developed Countries. Group established by the United Nations. To be classified as an LDC, countries must fall below thresholds established for income, economic diversification and social development. The DAC List is updated immediately to reflect any change in the LDC group.

Other LICs: Other Low-Income Countries. Includes all non-LDC countries with per capita GNP less than USD 760 in 1998 (World Bank Atlas basis).

LMICs: Lower Middle-Income Countries, *i.e.* with GNP per capita (Atlas basis) between USD 761 and USD 3 030 in 1998. LDCs which are also LMICs are only shown as LDCs – not as LMICs.

UMICs: Upper Middle-Income Countries, *i.e.* with GNP per capita (Atlas basis) between USD 3 031 and USD 9 360 in 1998.

HICs: High-Income Countries, *i.e.* with GNP per capita (Atlas basis) more than USD 9 360 in 1998.

Part II of the List comprises "Countries in Transition"; assistance to these countries is counted separately as “official aid”. These comprise (i) more advanced Central and Eastern European Countries and New Independent States of the former Soviet Union; and (ii) more advanced developing countries.

DEBT REORGANISATION: Any action officially agreed between creditor and debtor that alters the terms previously established for repayment. This may include forgiveness, rescheduling or refinancing.

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DIRECT INVESTMENT: Investment made to acquire or add to a lasting interest in an enterprise in a country on the DAC List of Aid Recipients. In practice it is recorded as the change in the net worth of a subsidiary in a recipient country to the parent company, as shown in the books of the latter.

DISBURSEMENT: The release of funds to, or the purchase of goods or services for a recipient; by extension, the amount thus spent. Disbursements may be recorded **gross** (the total amount disbursed over a given accounting period) or **net** (less any repayments of loan principal or recoveries of grants received during the same period).

EXPORT CREDITS: Loans for the purpose of trade and which are not represented by a negotiable financial instrument. They may be extended by the official or the private sector. If extended by the private sector, they may be supported by official guarantees.

GRANTS: Transfers made in cash, goods or services for which no repayment is required.

GRANT ELEMENT: Reflects the financial terms of a commitment: interest rate, maturity and grace period (interval to the first repayment of capital). The grant element is calculated against a fixed interest rate of 10%. Thus the grant element is nil for a loan carrying an interest rate of 10%; it is 100% for a grant; and it lies between these two limits for a loan at less than 10% interest.

LOANS: Transfers for which repayment is required. Data on net loan flows include deductions for repayments of principal (but not payment of interest) on earlier loans.

OFFICIAL AID (OA): Flows which meet the conditions of eligibility for inclusion in official development assistance, except that the recipients are on Part II of the DAC List of Aid Recipients.

OFFICIAL DEVELOPMENT ASSISTANCE (ODA): Grants or loans to countries and territories on Part I of the DAC List of Aid Recipients (developing countries) provided by the official sector with the promotion of economic development and welfare as the main objective and which are at concessional financial terms (if a loan, having a grant element of at least 25%).

ODA/GNI RATIO: To compare members'ODA efforts, it is useful to show them as a share of gross national income (GNI). "Total DAC" ODA/GNI is the sum of members'ODA divided by the sum of the GNI, i.e. the weighted ODA/GNI ratio of DAC members (cf. Average country effort).

OTHER OFFICIAL FLOWS (OOF): Developmentally relevant transactions by the official sector with countries on the DAC List of Aid Recipients which do not meet the conditions for eligibility as official development assistance or official aid.

TECHNICAL CO-OPERATION: Includes both (i) grants to nationals of aid recipient countries receiving education or training at home or abroad, and (ii) payments to consultants, advisers and similar personnel as well as teachers and administrators serving in recipient countries.

TIED AID: Official grants or loans where procurement of the goods or services involved is limited to the donor country or to a group of countries which does not include substantially all aid recipient countries.

VOLUME (real terms): Unless otherwise stated, data are expressed in current United States dollars. Data in national currencies are converted into dollars using annual average exchange rates. To give a truer idea of the volume of flows over time, some data are presented in constant prices and exchange rates, with a reference year specified. These data show the value of aid in terms of the domestic purchasing power of a US dollar in the year specified.

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