Multiple Crises and Developing Countries:

How to Allocate Aid Resources in the "New Normal"?

Carlos A. Primo Braga[1]

Introduction

Let me start by thanking ECOSOC and the Development Cooperation Forum for the opportunity to participate in this panel to discuss the "Impact of Multiple Crises: Allocating Resources among Competing Needs." As pointed out in the summary description of this session, developing economies have been hit by a series of exogenous shocks over the last few years. The financial crisis, which intensified in the last quarter of 2008, came on the heels of the food and fuel crises, and grew into a global economic crisis – the Great Recession. The crisis was "nurtured" by global macroeconomic imbalances, lax monetary policies in the developed world, an asset price bubble associated with excess investment in real estate, and poor corporate governance of the financial system.

It is true that we have seen this before – i.e., financial cycles leading to asset bubbles with international implications – but not on this scale. It is also true that most developing economies have shown a remarkable resilience in "navigating" these external shocks. There is no denying, however, that these shocks will further increase the challenges in meeting the Millennium Development Goals (MDGs). In what follows, I will address the following questions:

- Is the crisis over or should we be prepared to continue to handle a high level of fluctuations in world economic activity?
- What are the implications of the current economic environment for Official Development Assistance (ODA) flows and the MDGs?
- What areas of international assistance merit special attention? Can innovative financing help?

Is the crisis over?

The answer is "Yo," a combination of yes and no. No doubt the prompt and coordinated intervention of many governments has avoided the financial meltdown that many feared in the second half of 2008. The world economy has entered a recovery path, although the recovery remains fragile, unemployment rates in OECD countries extremely high and new challenges (e.g., sovereign debt distress in some countries) have emerged.

[1] C.A. Primo Braga is currently the Acting Vice-President and Corporate Secretary of the World Bank Group. Remarks delivered at the Policy Dialogue "Impact of multiple crises: Allocating resources among competing needs," Development Cooperation Forum, UN Economic and Social Council, 30 June 2010. The views expressed here are those of the author and do not necessarily reflect those of the World Bank Group.

It is also important to recognize that in a globalized economy external shocks get transmitted across countries in a much faster manner and with potentially greater impact. In other words, the "new normal" is one in which any given country is likely to face recurrent shocks, be it via trade channels, be it via finance channels. The good news is that developing countries have shown a much greater degree of resilience to external shocks this time than was the case in the past. Policy decisions associated with the accumulation of foreign reserves, improved efforts towards debt sustainability, increased reliance on equity flows rather than non-concessional debt, and the ability to pursue counter-cyclical monetary and fiscal policies (reflecting successful previous efforts to attain macro stability and to increase fiscal space) have contributed to this greater resilience. At the same time, this is not reason for complacency because the decline in growth rates has been significant in all economic regions (a decline of almost 6 percentage points in world output if one compares 2007 with 2009) and the possibility of new shocks ahead cannot be discarded. In sum, the resilience of developing economies will continue to be tested. The duration of the global economic slowdown and the capacity of policy makers to maintain sound macroeconomic policies in the domestic front will in the end determine the overall impact of the Great Recession on development prospects.

The Great Recession and the MDGs

The Great Recession has already impacted poverty alleviation prospects (e.g., by affecting the progress towards MDG 1). The centrality of economic growth for development is a well established proposition. With the deceleration of the world economy and the decline in growth rates in most developing economies, poverty reduction efforts were affected. It is worth noting that, even if the economic recovery is sustained in the years ahead, WB projections suggest that there will be an additional 53 million people leaving in extreme poverty (< $1.25/day) by 2015 compared with the pre-crisis trend. It is also important to recognize that growth collapses are particularly disruptive for human development outcomes. Their full impact on variables such as primary completion rates or under-five mortality can only be fully assessed over time. Accordingly, developing countries should be particularly attentive in monitoring these effects and in designing fiscal adjustments in a way that protects the most vulnerable segments of their populations.

A related issue concerns the availability of financing to continue to support poverty reduction efforts. The importance of official development assistance (ODA) in this context is critical for low-income countries. The debate about ODA commitments is often framed in terms of the "glass half full/half empty" metaphor. The good news, as pointed out by OECD/DAC, is that, despite the financial crisis, bilateral ODA has continued to increase and it is projected to reach $108 billion (in constant 2004 dollar terms) in 2010. The bad news is that this falls short of the global target set in Gleneagles ($130 billion) and the discrepancy is even more substantial in the case of Africa (an increase of $11 billion vis-à-vis 2004 in contrast with the Gleneagles' commitment of an additional $25 billion by 2010). Moreover, if the experience of how past donor-country banking crises have affected donor flows is of any relevance to predict the future, one should expect larger declines in aid flows in the years ahead exactly when the financing needs associated with the Millennium Development Goals (MDGs) targets will become even more urgent – a point made in the World Bank's Global Economic Prospects that was recently released.

Where to focus?

Let me conclude by briefly discussing priority areas for the development agenda. A recent paper on strategy prepared for the World Bank Group (entitled the Post-Crisis Directions) identified the following key priorities:

- Targeting the poor and vulnerable in Sub-Saharan Africa, the "bottom billion" located in fragile and conflict affected states and the 70 percent of the World's poor living in middle-income countries;
- Creating opportunities for growth through promoting agriculture and food security, addressing pressing infrastructure needs, and fostering an investment climate and private sector that encourages innovation and competitiveness, while engaging on critical public finance issues;
- Promoting global collective action to deal with global challenges (including via the development of innovative financing mechanisms);
- Strengthening governance in fragile and conflict-affected states;
- Managing risk and preparing for crises by developing global approaches to disaster and post-conflict needs assessments and helping countries design effective counter-cyclical policies.

These priorities also inform the discussions for the IDA 16 replenishment. It is important to keep in mind that this will be the last full IDA replenishment before 2015, the target date for the MDGs. IDA's central focus will continue to be the fight against poverty via its country-driven approach. Development results are the overarching theme of IDA 16, with special themes such as fragile states, gender, crises response, and climate change being discussed as areas for specific action.

Efforts in addressing specific developmental challenges have to be attentive to the question of "additionality." For example, the debate about mobilizing resources to help developing countries better adapt to the impact of climate change has led to growing concerns that this effort may shift resources away from core development needs. Accordingly, it is important to monitor closely the allocation of resources for climate change in parallel to conventional ODA flows. At the same time, the time for action is now. If there is one thing that we can predict with reasonable certainty is that the gap between long and short-term interest rates will increase as economies recover and public debt expands. This, in turn, suggests that the temptation to postpone policy actions that will affect the world economy in the long-term (e.g., climate change) will increase in the years ahead. Leadership now is required more than ever to advance this agenda in a way that explores positive synergies with financing for the MDGs and conventional ODA.

But ODA alone will not be able to deliver the financing or the growth patterns required for achieving the MDGs. Domestic resource mobilization in developing economies remains a must. Innovative financing can also help, although it is not a "silver bullet." Innovative finance is mostly about adapting or "packaging" available financial instruments in innovative ways to provide customized solutions to specific developing country challenges. It has been used to tap new sources and raise new funds but remains small compared to traditional ODA revenues. The biggest contributions to innovative flows from local currency bonds (US$ 10 billion in 2008), emerging donors (8.7 billion in 2008 or US$24.7 billion between 2004-2008), as well as specific initiatives like carbon finance (US$3.3 billion in 2009), *Output-Based Aid* (US$3.5 billion, 2002-2009, World Bank Group only), or the *International Finance Facility for Immunization* (US$2.8 billion 2006-2010).

Let me conclude by mentioning – as Mr. Alonzo Fulgham from USAID already did – the importance of collaboration among donors in tackling major developmental challenges. There are more than one billion people undernourished worldwide and infant undernourishment creates permanent casualties with long-term social and economic implications. Reducing malnutrition is critical for the success in advancing several other MDGs. Food security remains an elusive goal and the food, oil and financial crises have only added to the challenges in this area. In this context, the recent creation of the Global Agriculture and Food Security Program (GAFSP) for the financing of country-led agricultural development and food security plans is an important step in the right direction. GAFSP was set up as Trustee Account within the World Bank with financial support (so far amounting to roughly US$ 900 million) from the governments of Canada, Korea, Spain and the United States, as well as from the Bill and Melinda Gates Foundation. Rwanda, Bangladesh, Sierra Leone, Haiti and Togo were the first countries awarded GAFSP grants in June 2010 (totaling US$ 224 million). This is an example of multilateral action involving traditional and new donors, which is effectively responding to the challenges of our times. Thank you!