

POLICY COHERENCE FOR DEVELOPMENT: A TWO-WAY AVENUE

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1 Introduction

Policy coherence is the systematic promotion of measures across government departments and agencies, to have consistent approaches towards the achievement of agreed objectives. From a development standpoint, policy coherence also implies that developed countries, in pursuing domestic policy objectives in areas such as trade, agriculture, the environment or migration, should, at a minimum, avoid consequences which could adversely affect the development prospects of poor countries. This paper elucidates issues related to the coherence of development policy, cooperation and implications for the development impact of cooperation. The paper also examines the impact of policies implemented by developed countries on the autonomous policy space of developing countries.

2 Coherence of Development Policy

Development cooperation policy

Development cooperation policy aims at shaping the principles and rules of development cooperation and at helping to identify priority areas and modalities for support. The United Nations' Financing for Development, which led to the Monterrey Consensus in 2002 and the follow up Review on Financing for Development in Doha in 2008, identifies key issues for effective development cooperation. The issues include enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development as one of the leading actions. The consensus advanced actions, recommendations, and commitments to be undertaken by developing and developed countries on domestic governance and inter-ministerial coordination. Also, the Development Assistance Committee (DAC) of the OECD emphasizes the importance of ensuring that the relevant policies are consistent with commonly

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agreed development objectives. Similarly, the Paris Declaration (2005) puts forward an agenda for improving aid effectiveness including the harmonization of donor policy and alignment with national policy.

The agenda advocates for mutual commitment towards enhanced development assistance effectiveness by promoting improvements in: i) *ownership*, whereby developing countries decide their own strategies for poverty reduction, and improve their institutions; ii) *alignment* of donors behind these objectives, and use of local systems; iii) *harmonization*, which entails better coordination, simplification of procedures, and sharing information by the donor countries to improve accountability; and, iv) *mutual accountability*, on the part of the donors and developing partners alike for development results. According to this framework, aggregate resources need to be available to developing countries from the donors in terms of contributions to aid programmes, bilateral and multilateral, and donors should commit to improving their development assistance policies.

Subsequently, the Accra Agenda for Action (2008) aimed to accelerate progress on the commitments drawn up in the Paris Declaration. This new agenda provided further guidelines on the architecture and governance of development policy, specifically on how aid is given and spent. The areas of action put forward are: i) *Predictability*: 3-5 year advanced information to be provided by the donors on their aid plans to partner countries; ii) *Country systems*: partner country systems rather than donor system to be used to deliver aid; iii) *Conditionality*: donors to focus on the development objectives of the recipient country rather than on prescriptive conditions regarding use of aid; and, iii) *Untying*: donors to remove restrictions that prevent developing countries from using their own criteria on the allocation of aid, and from buying the necessary goods and services from the source of their choice.

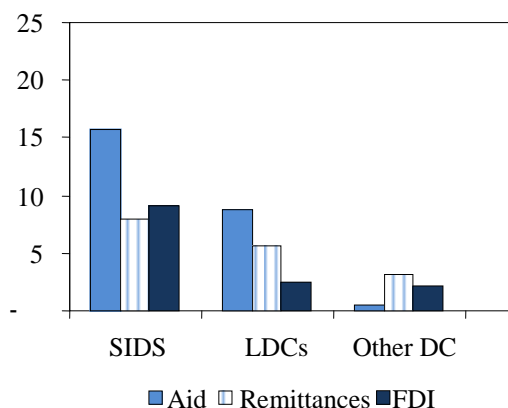
The application of the Paris Declaration remains uncertain. According to a comprehensive OECD survey, there has been some progress but it is unlikely that the Paris targets will be met by 2010 (OECD, 2008), particularly the principles of harmonization and alignment. Donor coordination has also become difficult, due to the entry of new donors and new programs (reflecting the enlargement of the European Union and the increasing importance of South-South and triangular cooperation).

Aid Modalities

Aid remains an important source of foreign financing for development for most developing countries particularly the least developed countries (LDCs) (see Figures 1 and 2). Official development assistance (ODA) plays a role in raising the levels of social investment, promoting the emergence of a strong private sector, as well as financial systems and trade facilitation in poorer countries. Development assistance is also part of the efforts to reduce both bilateral and multilateral debt in poor countries. Development cooperation programmes can have direct

impacts on poverty and social challenges in poorer countries. Moreover, aid has a positive and robust causal effect on growth over the long run.¹ Therefore, aid remains an important tool for enhancing the development prospects of poor nations.

Figure 1: Capital flows to developing countries, 1980 – 2006 (period average)



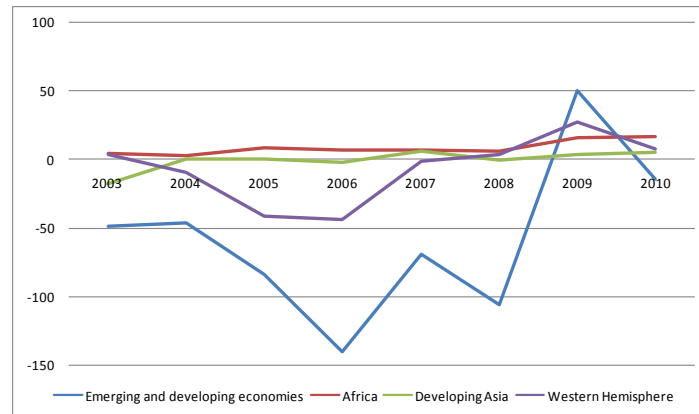
Source: author’s elaboration based on World Bank World Development Indicator (2009)

But aid modalities and the development assistance architecture are embedded with fundamental weaknesses. For instance, fragmentation, misplaced priorities, conditionalities, and the unpredictability of aid flows on the supply side (i.e. donors), as well as ownership, aid dependence, moral hazard, and absorptive capacity on the demand (recipient) side are latent issues². This is detrimental for building confidence in development cooperation and for improving aid effectiveness. These issues also have important implications for the type of aid, and modalities that would ensure the achievement of the MDGs.

¹ Arndt, C., S. Jones, and F. Tarp (2009), ‘Aid and Growth: Have We Come Full Circle?’, *WIDER Discussion Paper No. 2009/05* (October).

² Note 1 *ibid.*

Figure 2: Official Development Assistance to Developing Countries, net (in billion of US\$)



Source: Author's elaboration based on IMF's *World Economic Outlook*, 2010.

The modality of aid has evolved from project-based aid in the 1960s-1980s, to policy-based support (which founded the conditionality-tied aid in the 1990s), and more recently budget support, which addresses the major constraints of ownership and governance. The emergence of new aid approaches and the related institutional frameworks are a response to the weaknesses of the typical aid modalities, i.e. project-based aid, debt relief and balance of payments support, and assistance based structural adjustment. Currently, general budget support (GBS), sector budget support (SBS) and pooling fund arrangements under the Sector-Wide Approach (SWAp), together with the introduction of the Poverty Reduction Strategy Paper (PRSP) are major instruments, particularly in Africa. But, the relative merits of different aid modalities have been subject to significant debate with different sides of the debate arguing for specific aid modalities. Furthermore, contextual differences matter for the choice of aid modalities, which in turn can affect aid effectiveness. That is, the prerequisite of a successful aid programme is that the elements of a desirable development strategy are matched to an appropriate aid strategy and supported by well designed modalities and effective implementation.³

Implications for development policy

Despite the various initiatives of the development community, the framework of the development cooperation system remains unbalanced. Efforts concerning policy coherence for development often aim at improving the management and evaluation of the aid agency, programmes and projects. Issues of consistency involving policies, countries and agencies have been neglected. An example of incoherence between aid and non-aid development cooperation is

³ See, for example, Tarp, F., ed. (2000), *Foreign Aid and Development—Lessons Learnt and Directions for the Future*, New York & London: Routledge.

the impact of developed partners' agricultural policies on developing countries' food security objectives – which is one of the MDGs. Within the Doha Development Agenda (DDA), an objective is the phasing out of export refunds, reduction of market support, and other distorting subsidies. Development policy coherence could be more effective if efforts in development policy and cooperation were to extend beyond aid. That is why institutional coordinating mechanisms are indispensable to improving policy coherence.

3 Policy Coherence from various perspectives

Donors' perspectives

A key factor contributing to the improvement of coherence between donors has been the endorsement of the Millennium declaration. Specifically, the framework for overseeing the performance of developing countries – i.e. the Poverty Reduction and Strategy Papers (PRSP) system – represents a collective effort to improve monitoring and transparency, and is the donors' main tool for assessing the recipients' compliance. However, the PRSP initiative has placed greater emphasis and weight on the assessment of developing countries' performance than on the impact developed country policies may have on the probabilities to achieve the desired outcome.

Also, the framework makes greater demand on developing countries: only MDG 8 ('develop a global partnership for development') addresses the responsibilities of developed countries, and most of the agreed MDGs indicators (35 out of 48) directly concern developing countries. Even here the responsibility of the developed country is less.⁴ Thus, resources have been allocated to monitor the progress of policies and programmes in developing countries, but no similar effort is in place to monitor the improvement of policies in developed countries. A key area of incoherence also exists between agricultural policy and development policy, [as agricultural subsidies continue to hinder the ability of developing countries to export their agricultural products]. Although development policy coherence has legal implications, substantial ambiguity remains in the current application by advanced countries.⁵ Despite the persisting flaws in donor approaches, they advocate that developing countries still need to take more responsibility for their own development, through more effective design and implementation of development policy and through national resource mobilization.

⁴ Picciotti, R. (2005), Policy Coherence and Development Evaluation: Issues and possible approaches, in *Fostering Development in a global economy*.

⁵ For example, policy coherence has legal basis since 1992 in the Maastricht Treaty (Art 178). The agreement also refers to the aim of 'sustainable development' in stipulating the integration of environmental protection requirements in all Community policies and activities 'with a view to promoting sustainable development'. The multilateral trading system governed by the WTO also provides a legal basis for ruling trade relations.

Developing countries' perspectives on policy effectiveness

Channels of incoherence cited frequently by aid recipients with regard to development policy and cooperation between donors and recipients concern trade, international remittances, foreign direct investment (FDI) and external debt. The main challenge is the lack of an institutional framework for a more extensive and inclusive relationship between the parties. Aid recipients maintain that donor effectiveness requires deep commitment, responsiveness, and support for recipient government policy.⁶ Although there is a general consensus among recipients and donors on what makes aid effective, some divergence persists. Recipients' own views on the most effective multilateral donors suggest that the most important criteria of an effective donor are the deep commitment to the process of development (e.g. poverty reduction goals), responsiveness to developing countries challenges and circumstances, and support for recipient government policy.

Some studies confirm that donors' policies on trade, investment and aid do not contribute to development and poverty reduction; rather, in East Asia for example, autonomous policy efforts were responsible for the successful performance. The economic relationship between the East Asian region and OECD countries was unfavourable for the developing partners.⁷ Even more, OECD members' policies on tariff escalation and non-tariff barriers, particularly for processed products, have adverse effects on the development of food industries as well as on potential sources of employment, value added and scientific progress of the developing partners.

4 Development policy impacts: policy space and transmission mechanisms

Policy space

Institutional and policy reforms are usually considered to be the way to improve economic performance and growth in poor countries. Widely promoted and researched reforms over the past two decades include trade openness and industrial policy reforms, financial liberalization, privatization of state-owned enterprises, fiscal policy and monetary policy reforms, and judicial development. In this regard, there are clear voices calling for a greater role of the government and the proactive role of economic policy, especially in a more globalised environment.⁸ The experience of many of the newly industrialized countries, particularly East Asian economies,

⁶ Wathne, C. and E. Hedger (2010), What does an effective multilateral donor look like?, *ODI Project Briefing No. 40* (April).

⁷ Fukasaku K., Kawai M., Plummer, MG, Trzeciak-Duval A. (2005), *Policy coherence toward East Asia: Development challenges for OECD countries*, OECD Policy Brief No 26.

⁸ Stiglitz J. et al. (2006), *Stability with Growth: Macroeconomics, Liberalization and Development*, Oxford: Oxford University Press.

such as South Korea and China, serves as testimony that state-led development policy can be successful.

Globalization has contributed to the improvement of the overall economic performance of developing countries, by opening up market opportunities for their exports, by promoting the transfer of information, skills and technology, and by increasing the financial resources available for investment. But increased integration has also brought new challenges for growth and sustainable development. Some nations have successfully adapted to the changes and profited from globalization, but others have been less successful in reaping the benefits. The growing political and economic integration, and the commitments inherent to bilateral and multilateral relationships, limit the ability of developing countries to pursue national development policies. This means that policy space, defined as “the scope for domestic policies, especially in the areas of trade, investment and industrial development, is now often framed by international disciplines, commitments and global market considerations”.⁹

The literature argues that the multilateral trading system is eroding the ability of nations to implement policies for growth and sustainable development, by narrowing the range of possible policy options allowable under international trade and finance accords. In light of today’s economic and social disparities the rationale for upholding policy space in trade negotiations is justified more than ever.¹⁰ That is, the multilateral trading systems can have adverse effects on countries at earlier stages of economic development. International trade agreements have seemingly equivalent rules for all parties, but provide lesser policy space for the developing countries than the developed ones, because of differences in initial conditions and institutional capabilities¹¹. It is often proposed that special and differential treatment (S&DT) for developing countries, permitted under the WTO rules, needs to be enhanced and made more effective in order to ensure that developing countries have essential national policy space for development.

A balance between policy goals and instruments

A meaningful policy space must extend beyond trade policy and include macroeconomic and exchange rate policies that will help to achieve development goals. Considerable policy autonomy in macroeconomic and exchange-rate policies in developing countries still remains. This is particularly the case for the increasing number of developing countries which have a

⁹ United Nations Conference on Trade and Development, UNCTAD (2004), ‘São Paulo Consensus’, *UNCTAD TD/410*.

¹⁰ DiCaprio, A. and K. Gallagher (2006), ‘The WTO and the Shrinking of Development Space: How Big is the Bite?’, *Journal of World Investment and Trade*, 7(5), pp. 781-803.

¹¹ At the onset of the ‘Doha Round’ round of global trade negotiations under the WTO, which commenced in November 2001, developing countries agreed to enter a new phase of trade negotiations only on the condition that development would be the focal point. Key among those concerns is the notion that a new trade agreement will not give the developing world the “policy space” to use the exact instruments and tools that many industrialized nations have afforded to reach their current levels of development.

strong external position – either because of substantial revenues from commodity exports or a deliberate accumulation of foreign-exchange reserves – and which are not subject to International Financial Institutions (IFIs) or donor conditionality.¹²

Policy space and the effectiveness of national policy instruments are affected not only by international rules but also by global market conditions and by the policy decisions of other countries. Moreover, global integration affects policy space through several factors that work in opposite directions and the effect on policy space differs according to country and the type of integration.¹³ While integration into global markets might reduce the efficiency and scope of national macroeconomic policies, it can improve the effectiveness of many structural policies that are of crucial importance for developing countries – notably industry-wise strategies and technological upgrading, especially during the initial stages of industrialization. That is, economic integration facilitates access to foreign technologies and, at the same time, the foreign exchange from exports alleviates balance-of payments constraints.¹⁴

The impact of external constraints on national economic policies, including multilateral rules and obligations, set up without the inclusive participation of all countries concerned and biased against the interests of some country groups, has impacted the range or effectiveness of national policy instruments. Therefore, appropriate action needs to be undertaken at the international level to reduce the exposure of developing countries to adverse spillover effects, and negative externalities from external policies. This implies that, alongside promoting multilateral solutions that address trade and financial systems imbalances, as well as inconsistencies in governance, regional collaboration and cooperation amongst developing countries with mutual interest (i.e. South-South and triangular cooperation) should be fostered.

5 Emerging development issues

Addressing global challenges

To improve development policy coherence donors need jointly to address persisting global challenges, i.e. climate change, trade, capital flows and migration. That is, efforts should aim at establishing long-term coherence between trade policy, financial policy, and development. A comprehensive plan needs to look at issues concerning agriculture, competition, development partnership and governance, foreign investment, knowledge and innovation, sustainable development, trade and fiscal policy. According to OECD it could encompass the following actions¹⁵:

¹² See Mayer, J. (2008), Policy Space: What, for What, and Where?, *UNCTAD Working Paper* No. 191 (October).

¹³ UNCTAD (2006), *Trade and Development Report 2006*, Geneva: Switzerland.

¹⁴ Santos-Paulino, A.U. and A.P. Thirlwall (2004), 'The impact of trade liberalisation on exports, imports and the balance of payments of developing countries', *Economic Journal*, 114 (493), F50-F72.

¹⁵ OECD (2008), *Survey on Monitoring the Paris Declaration: Effective Aid by 2010*, OECD: Paris.

- Improve market access for manufactures; reduce technical and quantitative restrictions to trade; relax agriculture and fisheries policies which have lasting negative spillovers effects in developing countries, and at the same time provide improved market-access, and technical support.
- Strengthen the framework for international investment and capital flows – both official and in the form of private investment (remittances, FDI, etc.).
- Reconcile environmental concerns with the broader trade and investment and development systems.
- Rethink the role of international migration for economic and social progress in low-and middle-income countries.

Expanding global partnership

In response to existing development challenges, and to counteract exogenous shocks such as the recent global economic downturn, both developing countries and the donor community have sought not only more financial flows but better financial opportunities. These include, inter alia, joint ventures that mobilize private finance for public service delivery, risk mitigation efforts that promote private entry in the productive sectors, and support for carbon trading.¹⁶ Thus, innovative finance mechanisms have emerged or are being proposed, with the increasing participation of private agents and public- private partnerships. Yet, innovative fund-raising should be viewed as a complement to—rather than a substitute for—traditional efforts to mobilize official flows, in particular concessional flows. Donors should be realistic about the potential of innovative schemes to generate additional flows, and associated risks such as aid proliferation and associated transaction costs.

6 Way forward

Potential gains from growth and global integration can be halted by the incoherence in development policy that result from asymmetric development levels, as well as policy design and implementations, thus affecting collective governance. In line with challenges discussed herein, to achieve policy coherence, donors and IFIs need to ensure security and political stability, foresee the impacts of macroeconomic policies on developing-country growth, increase both market access and capacity-building for developing economies; support governance structures that help to maintain financial stability; and improve aid effectiveness in developing countries. In this regard, the completion of pending international commitments such the Doha Development

¹⁶ Girishankar, N. (2009), ‘Innovating Development Finance: From Financing Sources to Financial Solutions’, *World Bank Policy Research Paper* No. 5111.

Round is fundamental. The monitoring and evaluation process for policy coherence remains a challenge. These mechanisms need to be more context-specific based, with emphasis on comparative country case studies with regard to development policy coherence.

7 Questions for discussion

- a) How can policy coherence be addressed in the international aid architecture to improve development effectiveness? What lessons can be learned and what are the key challenges?
- b) What are the different global policies that affect developing countries? What impacts do these policies have on development? What are the stakeholders' experiences? How can we make Policy Coherence for Development work better for the achievement of the MDGs?
- c) How can global challenges such as trade, social dimensions of globalization, climate change, food security, gender equality, migration and security be addressed so that we will also boost development?
- d) What are good examples of coherent responses of development actors in the context of fragile and conflict situations, in particular with regard to gender equality as one of the central features in this regard?
- e) How can ODA be better used as a catalyst for other sources of development finance? How can coherence be ensured between ODA and other financing flows and mechanisms?