Report of Panel discussion on

Moving Out Of Aid Dependency

Second Committee Special Event

Friday, 16 November, 10 a.m. - 1 p.m.

The Monterrey Consensus and the 2005 World Summit stressed that recipient and donor countries, as well as international institutions, should strive to make ODA more effective by using development frameworks that are owned and driven by developing countries. In addition, it called for the harmonization of operational procedures to the highest standard so as to reduce transaction costs and that initiatives such as untying of aid should be supported and enhanced. Moreover, the Consensus recognized the need to enhance the absorptive capacity and financial management of recipient countries. At the 2005 World Summit, Member States also welcomed recent efforts and initiatives to enhance the quality and impact of aid, including the Paris Declaration on Aid Effectiveness.

The panel discussion "Moving Out of Aid Dependency" was a special event of the Second Committee organized by the Financing for Development Office on November 16, 2007 at the United Nation's Headquarters intended to provide inputs to the on-going policy discussions at the United Nations on the road to Doha in 2008 and look at a critical issue – How does an aid dependent country move out of aid dependency in the long-run? By addressing key issues in the context of the development paradigm needed for a country to move out of aid dependency, governments will be better able to map out a long-term development plan and donors can map out a delivery mechanism to align aid to this development plan. Financial aid flows to developing countries represent important resources to improve socio-economic conditions. Given the multiple needs and the limited resources it is key for donor and recipient countries to make the most efficient possible use of aid, but at the same time the aid given should not prevent the creation of economic conditions so that the recipient countries eventually become less dependant of aid, and rely on its indigenous resources in the long run.

The panel benefited from the rich intellectual blend and points of view of the speakers; distinguished economists, heads of non-governmental organizations, diplomats, and policy makers sat at the table to share their knowledge on aid dependency and the most effective way for developing countries to reduce such status. The panel was chaired by Mr. Peter Le Roux (South Africa) vice-chair of the second Committee. The speakers were Mr. Poul Engberg-Pedersen, Director General, Norwegian Agency for Development Cooperation; Mr. Roy Culpepper, President, North-South Institute, Ottawa, Canada; Ms. Irma Adelman, Professor, Berkeley University, California; Mr. Michael Atingi Ego, Executive Director, Bank of Uganda, Uganda; and H.E. Mr. Debpriya Bhattacharya, Ambassador and Permanent Representative of Bangladesh to the United Nations at Geneva. Benu Schneider, Chief of International Finance, Debt and Systemic Issues Unit
Financing for Development, Department for Economic and Social Affairs was the discussant.

To stimulate the discussion, the Chair Mr. Peter Le Roux (South Africa) posed some questions to the panel of experts:

- What is the development paradigm needed for countries to move out aid dependency?
- What do we learn from the experience of investments in social expenditure?
- What is the experience of countries who have graduated from aid to other type of flows?
- How can the aid machinery be further reformed to enhance aid effectiveness by aligning aid delivery to an overall development strategy?

- What improvements can be made to the criteria to be used for allocating aid to enhance its effectiveness?

The following is a summary of the discussion:

i) Aid is often a tool of donor foreign policy to achieve certain policy goals.

Mr. Engberg-Pedersen opened his presentation stating that aid is a tool of foreign policy by donors. In his view, aid is an instrument and aid dependency a mindset problem as opposed to a financial constraint and moving out of aid dependency requires cultural emancipation by both donors and recipients. Since development and development cooperation are political issues, emphasizing politics in development cooperation puts aid in the proper perspective, that is, an instrument of cooperation. Norway, in consonance with this thesis, ties aid to its foreign policy.

Aid is not only a reflection of bilateral/multilateral cooperation and humanitarian assistance, but also an amalgam of many factors, including size of aid, channels, actors, rules and regulations governing its flow.

Mr. Engberg-Pedersen highlighted that in order to move out of aid dependency donors must recognize their self-interests and be open about their political goals; must focus on results and alignment than on harmonization; must recognize that aid is an instrument in the ever-more complex international policy regimes on climate change, terrorism, human trafficking, epidemics, energy and human rights; must counter the strong forces of bureaucratization.

ii) Instead of concentrating on the process, donors should concentrate more on end results. The PRSP process is a consultative one but does not ensure ownership.

Mr. Engberg-Pederson and Mr. Roy Culpeper stated that in order to enhance aid effectiveness donors should concentrate on end results rather than their processes.

Mr. Roy Culpeper stated that in order to enhance aid effectiveness, developing countries must broaden national ownership to include Parliament, civil society, private sector and local government councils into their policy makings. It is also necessary to strengthen a way to finance its own development through domestic resource mobilization.

Mr. Engberg-Pedersen stated that aid should be considered just as an instrument and not as a final objective. In order to wean partners from aid dependency donors apart from openness about political goals, donors should focus more on results and interfere less in process, offset bureaucratization, and remember that aid is an instrument with which to achieve goals. Into arriving at a new aid realism, he concluded that recipients must create political space for aid utilization, broaden concepts of "local ownership" so that aid projects are driven by local people rather than donor governments. It is necessary that developing countries be given the policy space to develop their own development finance mechanisms. Governments must improve voice/participation in global institutions in discussion of global public goods and bads and remember that aid is just a tool achieve goals. He stressed the point that aid, as part of total financial flows, is not very substantial. In contrasts the needs are large and the objectives are ambitious. Therefore in a context of scarce resources and multiple needs, it is important to remain realistic on what aid can do. He also stressed the importance of improvements in governance in both donor and recipient countries. Political dialogue should be given priority in order to increase aid efficiency. A follow up of the results agenda is also essential.

Mr. Culpeper cited the results from a recent project on "Southern Perspectives on Reforming the International Development Architecture" carried out at the North-South Institute with the participation of developing countries that the PRSP is a consultative process but does not ensure ownership.

iii) Delivery of aid falls short

Mr. Bhattacharya noted that since 2000 total and per capita ODA flows in nominal terms has increased, but there is no significant change in real terms. Part of the increase in ODA was due to emergency assistance and debt forgiveness. The ODA flows are skewed favoring failing economies such as Afghanistan and Congo. From his perspective, Bangladesh is an example of a country moving out of "extreme" aid dependency. This country has decreased the ODA inflow as percentage of GDP and at the same time it has increased the exports and remittance flows, so it moving from aid to trade dependency. However there are still critical sectors in which Bangladesh still needs ODA flows. In general to decrease aid dependency donor countries need to improve the access to markets for commodities and persons, and recipient countries need to promote higher quality FDI flows and enhance domestic resource mobilization in terms of savings and tax. Innovative forms of development finance include partnership between private and public sectors, private donations, develop a global pollution tax system, a Global Lottery, and a Global Premium Bond.

iv) Development strategies encompass a wide array of investments; flexibility is needed to make shifts in development paths funded by aid and other development finance with little conditionality.

The example of the Republic of Korea by Ms. Adelman described a successful case of applying a dynamic and flexible approach to development where policy shifts enabled the country to reach its present level of development. She pointed out that Korean development is a good example of a country that successfully transformed its economy from natural-resource production based to a labor-intensive production one then to a skill-intensive one, and finally to a knowledge-based one. Although the importsubstitution policy in the 1980's was unsuccessful, a shift back to manufacturing exports led to recovery in heavy industry. Korean development was enabled by intensive investment which was accompanied with a flexible change of economic and social policy as well as trade and investment policy. The Republic of Korea was aided in its development strategy by aid flows with little conditionality.

Mr. Roy Culpeper stressed that developing countries should reduce their aid dependency and debt overhang to reduce conditionality and leverage of donors. It is necessary that developing countries be given the policy space to develop their own development finance mechanisms.

Mr. Roy Culpepper said that in order to solve such problems he suggested the increasing flexibility in the use of funds (export diversification, infra-structure development, and financial reforms), better institutions, investment in the creation of a knowledge bank in the South, national development plans, improve aid delivery mechanisms.

According Mr. Culpepper developing countries must formulate and implement coherent national strategies and consistent priorities . It is also necessary to reinforce legitimacy of the international development architecture but rectifying imbalances between donor and recipient countries (voice and participation in multilateral fora, need new mechanisms or processes of accountability on both sides, less intrusive conditionality, strengthen regional actors, including UN system, etc). Aid effectiveness can be enhanced through, among others, greater accountability (widen OECD DAC peer review mechanism to include recipients, spend more technical assistance funds on local experts, increased budget support needed to reduce multiple donor coordination and harmonization problems). In addition Mr. Culpepper stressed the need for a more development friendly trade and investment agenda.

From the perspective of Mr. Bhattacharya, a new role of aid is needed, as well as finding other sources of finance other than aid. He agrees in the importance of distinguishing the heterogeneity of countries and their needs in order to use aid efficiently. He is in favor of an ownership alignment harmonization and increased political commitment as a strategy to take full advantage of aid flows.

Ms. Schneider pointed out that the aid architecture is a complex, uncoordinated and fragmented system which needs to be simplified and harmonized, and where the voice of recipient countries could be taken more into consideration.

v) The present system is too focused on temporary safety nets and macroeconomic stability and needs to be embedded in an overall development strategy.

Mr. Antigi-Ego mentioned that developing countries need aid because of the gap between investment and savings. Given that aid in social expenditure take long time to materialize (for example, education), it is suggested that aid should also be focused on helping countries to promote trade as a way to decrease the savings-investment gap. He referred to the Uganda's case of tax base reform which has successfully increased public expenditure on social sector. Moreover constraints imposed by IMF have been limiting country's fiscal autonomy in increasing public expenditure in all sectors including the social sector.

Mr. Atingi-Ego pointed out that for Uganda aid has not provided for improving its productive capacity, trade capacity, infrastructure and financial sector reforms. As a result, aid had little impact on productive investment. He also pointed out that too much aid risked crowding out private sector activities.

Ms Schneider pointed out that developing countries often receive policy advice that is inconsistent with long term development and growth objectives. Uganda represent a typical case to illustrate this problem: it is aid dependant and receives budgetary support for social expenditure under HIPC. However, aid conditionality had caused a failure to use funds for building up productive capacity including trade capacity. Thus Uganda could not absorb the aid completely due to conditionality on the use; this caused a build-up in reserves and sterilization, leading to higher domestic debt with rising interest costs affecting public debt sustainability. Social investments are not enough – they need to be embedded in a more complete development framework.

The example of India was cited to illustrate the situation where the government took an active role in financing public sector investments in strategic sectors in its early stages of development. Infrastructure and good governance are important in order to attract aid flows nevertheless institution building take time.

vi) BWI and WTO rules prevent sources of financing which were available to countries like the Republic of Korea that moved out of aid dependency.

Several panelists highlighted the inconsistency of some policies emanated from the Washington consensus in relation to decrease aid dependency. For example Mr. Roy Culpeper noted that policy coherence in the area of aid, trade, investment and other policies are often inconsistent by themselves. Particularly, many developing countries had been forced to adopt trade liberalization policies and had subsequently faced it difficult to replace the forgone revenue by value-added tax or other taxes. The international development architecture lacks legitimacy from developing countries perspectives for a number of reasons. At the global level a more equitable balance in decision-making and voting power is needed at Bretton Woods institutions and WTO. At the country level, less intrusive conditionality is needed. Irma Adelman pointed out that the prevailing WTO rules discourage tariffs which were an important source of development financing which available to the Republic of Korea Korea in its early stages of development..

Critics of Poverty Reductions Strategy Papers point to bias towards social sectors squeezing out the more traditional development dimensions of ODA. They in essence reflect the Washington Consensus, emphasis on governance and temporary safety nets.

vii) Liberalizing migration can be an important source of financing development through remittances. Investment in the creation of a Knowledge Bank of the development experience of the South is necessary.

Mr. Bhattacharya stressed the role of remittances and movement of human capital as possible factors that can contribute in an important manner in decreasing aid dependency. Mr. Bhattacharya stated that Bangladesh succeeded in moving out of extreme aid dependency to moderate aid dependency because of the increase in remittances and exports.

Mr. Culpepper suggested that for future discussions it will be useful to consider the role of new development partners such as China, India, Brazil and South Africa. In his opinion the OECD is not a good forum to discuss aid issues because new donors are not included. Mr. Culpepper stressed the importance of South-South cooperation and put as an example the creation in Latin America of Banco del Sur. Domestic resource mobilization is important but difficult at the same since many developing countries have been advised to reduce trade barriers, leading to a decrease in tax revenues.

The representatives of the countries that attended the panel discussion manifested their deep interests in the reflections expressed by the panelists and acknowledged the Financing for Development Office for the organization of the panel. The interventions of the Representatives referred to the following topics:

- To increase aid efficiency, there is a need to distinguish among three recipient countries: 1) developing countries; 2) low income countries; and 3) post-conflict countries. The needs of each of these countries are different for example, aid to post-conflict countries should be focused on improve security, stability, and infrastructure.

- A deeper discussion on external debt crisis and market access.
- Acknowledged the presentation of Ms. Adelman about the Korean experience of moving out of aid dependency and, although each country has its own specific economical and political characteristics, it is hoped that the Korean example could be useful for other countries.
- In addition to the experiences presented interest was shown in the experience of other Asian nations such as Malaysia in moving out of aid dependency.
- Some representatives agreed that there are serious shortcomings with the present aid and financial architecture. They recognized the failure to use aid fully and requested comments on the role of the state on aid issues.
- It was suggested that efforts to promote private sector development is another strategy to move out of aid dependency.
- Queries on how to enhance domestic resource mobilization (savings, tax revenue, remittances) in Africa
- Request for further information on the creation of a South-South Knowledge Bank