Written evidence submitted by the TUC

1. The TUC appreciates the opportunity to take part in the inquiry into development finance, notes its relevance to the debate on the post-2015 Development Agenda and hopes that its views will be taken into serious consideration and reflected in the IDC recommendations.

Will the 0.7% ODA target be appropriate in the long term?

2. The TUC and its affiliates have long advocated the maintenance of the UN-recommended target of 0.7% of Gross National Income (GNI) as Official Development Assistance (ODA), reiterated our position in previous submissions[1] and mobilised support in the international trade union movement for increased ODA.
3. The TUC is of the view that it is appropriate to maintain the target in the long-term, although it may not be adequate in view of the rapidly growing needs for development and related issues such as climate change and protection of the environment. The long-standing[2] and painstakingly built global[3] consensus[4] around the UN-recommended target is worthy of consolidation and preservation. Moreover, it is unwise to call into question its validity and relevance, especially, in view of the pledges made by a number of countries[5] including the UK[6] to reach the target by 2015. Five – Norway, Sweden, Denmark, the Netherlands and Luxemburg[7] – have consistently fulfilled their pledges. It would also run counter to the current initiatives supported by the three main political parties to enshrine the target in legislation. It would, in our view, be virtually impossible to agree on a similar target at national or global level in the foreseeable future.
4. The doubts over the appropriateness of the target are likely to adversely impact on the feasibility of any future development agenda, notably, the post-2015 Development Agenda currently under discussion. While agreeing with the need for the search of additional sources of funding, the TUC does not favour any initiative potentially detrimental to existing mechanisms capable of generating funds for development. On the contrary, we would support any measures aimed at further consolidating existing arrangements[8] to ensure predictability[9] and adequacy[10] of ODA.

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[1] All Party Parliamentary Group for Debt, Aid and Trade, TUC Response to the Inquiry into *Increasing Aid Finance, 2007*

[2] In 1969, the Pearson Commission proposed that ODA be raised to 0.7% of GNP by 1975, which was endorsed in a UN resolution in 1970.

[3] Switzerland was not a member of the UN until 2002.

[4] US, while accepting the concept in principle, has rejected targets or timetables.

[5] 16 European countries have pledged to reach the target by 2015.

[6] *We also deliver in this coming year on this nation's long-standing commitment to the world's poorest to spend 0.7% of our national income on international development. We should all take pride, as I do, in this historic achievement for our country, Chancellor of the Exchequer, on 20 March 2013, Budget Speech.*

[7] The contributions from the five countries concerned as a percentage of their GNI were as follows in 2012: Denmark (0.84%) Luxemburg (1%) Netherlands (0.71%) Norway (0.93%) Sweden (0.99%) DAC 2013.

[8] Visit http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/137320.pdf, for EU concerns over ODA

[9] The predictability of aid has been a major concern for many developing countries, especially those highly dependent on aid. "We will increase medium-term predictability of aid", Paris Declaration on aid effectiveness and the Accra Agenda for Action, OECD, Para 26.

[10] Net ODA as a % of GNI dropped from 0.31% in 2011 to 0.29% in 2012, DAC Update, March 2013. This reflects a 4%- drop in real terms.

5. The UK is an important DAC member[11] and wields influence on the formulation of aid policies and practices in the European Union and international financial institutions. Any dilution of the commitment of the UN-recommended target by the UK is likely to set a precedent for other developed countries, notably, for other DAC members[12] and will not bode well for the current initiatives to increase funding for development.

Has the DFID the right mix of financial instruments? Should it introduce new ones, including concessional loans? And the role of the UK as a provider of climate finance?

6. The UK decided to limit its ODA to grants and gradually phase out other forms of ODA after careful consideration of serious shortcomings associated with the mix of financial instruments, which was applauded by the DAC[13] and the international development lobby both at home and abroad, especially, in the case of Least Developed Countries (LDCs).
7. Recent ODA flows from the UK follow the trend in favour of grants in relation to both bilateral and multilateral aid and are in tune with the general trend within the DAC. While recognising the need for concessional loans in exceptional circumstances, the TUC does not support a radical shift in favour of loans and other financial instruments in UK aid for a number of reasons.
8. UK aid is increasingly concentrated on a smaller number of countries, notably LDCs and fragile states already faced with severe financial constraints as well as socio-economic factors retarding their development. It would be imprudent to grant loans even at low interest rates to LDCs and low-income countries in general, as the accumulation of debt – principle and interest – over the years could threaten the stability of their vulnerable economies.
9. Moreover, UK aid is focused on some key sectors – health, education and water and sanitation in particular – vital to human development and future wellbeing of recipient nations. Public opinion in the country is unlikely to be amenable to aid mechanisms that would require some of the poorest nations to borrow funds from rich nations to build schools, hospitals, sewerage systems etc and repay them with interest, albeit, at concessional rates.
10. There is growing criticism of current methods of calculation of the degree of concessionality – grant element – of loans taken out by some developing countries from developed nations including France and Japan. In fact, the methods used by DAC[14] tend to inflate the grant element significantly, disguising credit given to, especially, Middle-Income Countries (MICs) as loans at concessionary rates[15]. The UK Government's pledge to increase ODA and reach the UN-recommended target of 0.7% of GNI in 2013 has won praise from many quarters and the use of part of the increase in funds to be

[11] UK has been a DAC member since 1961.
[12] ….. the UK is in many ways seen as a model by other donors. This gives the UK a special responsibility, DAC Peer Review of the UK, 2010, p13
[13] There had been broad consensus on the need for grant aid within DAC when a formal agreement on it was reached in 1972.
[14] See letter to FT by Richard Manning, former Chair of OECD DAC on 9 April 2013.
[15] The TUC favours two changes – use of a more realistic discount rate instead of the current rate of 10% and consideration of only grant element as ODA. At present, all loans with a grant element above 25% are considered to be ODA.

loaned out will diminish the value of the gesture and call into question its significance in real terms.

11. It is evident from past experience that there is no guarantee that a nation saddled with unsustainable debts will not default on repayment and that creditors will be forced to write them off often through a process of protracted and arduous negotiations. Developed nations like the UK have gone through the process and it is hard to justify moves to put in place arrangements likely to lead to similar scenarios[16] in future. Debt forgiveness itself has been surrounded with controversy with the criteria used for debt relief varying significantly, sometimes even being closely associated with overt political calculations[17].
12. The UK has already set up an International Climate Fund (ICF) to "support international poverty reduction by helping developing countries to adapt to climate change, take up low carbon growth and tackle deforestation[18]" in an effort to contribute to the delivery of international climate change objectives. The Government has undertaken to adhere to the DAC definition of ODA in the disbursement of funds from the ICF in addition to giving assurances to observe guiding principles on aid effectiveness and value for money. The TUC supports the Government's initiative in this regard and hopes that priority will be given to job creation and social protection in the sectors concerned.

Should the UK establish a new, independent development finance institution to offer concessional loans?

13. As argued in previous paragraphs, the TUC does not advocate a shift in favour of concessional loans in place of the current practice of outright grants and therefore does not support the establishment of a new independent finance institution for concessional finance. However, the TUC has no objections to the setting up of a separate financial institution for concessional development finance if the new institution is to provide additional finance for development[19].
14. The UK is a significant contributor[20] to international financial institutions, notably, the International Development Association (IDA) which provides concessional finance for development for 82 low-income countries[21]. The use of part of the funds currently set apart for ODA for the establishment of a new financial institution is bound to have an adverse impact on the UK's continuing support for the IDA and other multilateral financial institutions. The UK, in our view, is in a better position to achieve its objectives of the elimination of extreme poverty and promotion of economic growth in poor countries through close collaboration with the IDA –institution highly commended in the DFID's own review[22] in 2011.

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[16] The total cost of forgiving debts of 39 countries eligible for debt relief under the Highly Indebted Poor Countries (HIPC) initiatives was estimated at USD 76bn in end-2011 net present value terms, IMF factsheet on HIPC, April 2013

[17] Some researchers point to the number of years of colonial rule, voting patterns in the UN, openness to trade etc as important determinants of debt forgiveness adopted by some developed countries, Eric Neumayer, LSE, World Development, Volume 30, No 6, 2002.

[18] International Climate Fund, Implementation Plan 2011-12/2013/2014, Technical Paper, UK Government

[19] if it is funded out of resources outside the UK aid budget set to reach 0.7% of the country's GNI in 2013

[20] In 2010, UK pledged £2.7bn to the IDA-16, representing 15.6% of the total value of donor pledges.

[21] 40 of which are in Africa and many are among the DFID target countries.

[22] IDA scored 39/52 or 75% in the MAR.

15. The provision of concessional finance for development could be achieved more effectively through regional development banks such as the Asian Development Bank, African Development Bank and similar regional financial institutions rather than through a separate financial institution. In fact, the DFID is already providing concessional development finance indirectly through its support for regional development banks.
16. The Commonwealth Development Corporation (CDC) is a development finance institution wholly owned by the UK Government. It fulfils the role of the provider of development finance for the private sector in developing countries in Asia and Africa and has investments in 77 countries. If the Government is keen on the provision of further finance for the private sector, it can do so by increasing the capital of the CDC[23], enabling it to invest more in businesses and create jobs in developing countries without creating new finance institutions for the purpose. The TUC has consistently called upon the DFID to ensure that the CDC strictly adheres to its investment code including the respect of Core Labour Standards and believes that further finance should be made available only when it has fulfilled the obligation.
17. There is growing criticism of loans granted to developing countries in the guise of concessional finance by some developed countries, notably, Japan[24], France and Germany[25]. There is concern over the impact of payment of interest and repayment of principle on the net transfer of resources from developing countries to developed countries. The TUC is also conscious of the possible slippage from concessional loans to tied aid[26] – practice disapproved by the development community[27] which the UK has been able to wean itself from.

Has the DFID got the right balance between bilateral and multilateral aid?

18. The balance between bilateral[28] and multilateral aid should be contingent on the aims and objectives of donors and those of recipients and, in our view, there is no hard and fast rule about the ideal balance[29]. The publicly declared objective of UK ODA being poverty reduction in poorer countries through the achievement of Millennium Development Goals[30] (MDGs), on the whole, the TUC considers the current balance of roughly 60% and 40[31]% between bilateral and multilateral aid to be appropriate. However, the TUC would like to see changes in the current allocation of resources between multilateral institutions. Moreover, while recognising the need for concentrating aid on the Least Developed Countries, the TUC remains firmly of the view that aid to

[23] The CDC claims that it has not received any new funds from the Government since 1995.
[24] Japan introduced Special Terms for Economic Partnerships (STEP) loans in 2012.
[25] See, for instance, Rob Tew, ODA Loans, Discussion Paper, Development Initiatives, Feb 2013
[26] Japan was asked to consolidate progress in untying its aid in the DAC Peer Review in 2010, p72.
[27] See, Untie Aid, Para 31, Paris Declaration
[28] It should be noted that some bilateral aid is disbursed through multilateral institutions.
[29] In 2011, bilateral aid was 58.39% of total UK ODA.
[30] DFID's overall aim is to reduce poverty in poorer countries, in particular through achieving the Millennium Development Goals (MDGs), 1.6, DFID Annual Report 2012, see also International Development Act 2002.

[31] The UK part (40%) is roughly equivalent to DAC average. See, What do we know about multilateral aid? The 54 Billion Dollar Question, DAC, OECD, 2012

Middle Income Countries with large numbers of poor people[32] should be continued for the foreseeable future.

19. The TUC does not favour a significant drop in the proportion of UK Aid channelled through multilateral institutions for a number of reasons. Multilateral aid is more effective due to economies of scale in delivery, availability of best technical expertise in specialised agencies, better coordination of policies and practices, and legitimacy due to their global presence. One may recall that the Multilateral Aid Review[33] commissioned by the UK Government concluded that the WB Group was one of the most effective multilateral institutions that the DFID funds[34]. Multilateral aid could be an effective means of intervention in politically sensitive and fragile situations[35].
20. A slight increase in multilateral aid could be appropriate under the current circumstances. The pledge to increase ODA towards the UN-recommended 0.7% of the country's GNI and reach the target in 2013 is of great importance and will be a significant milestone in UK aid disbursement. In view of the reduced GNI due to recession, the UK Government will now be able to reach the target at a lower level in absolute terms. Nevertheless, if the target is to be reached in 2013, ODA will need to rise by 27.5% and 2.5% in 2013 and 2014 respectively[36]. In our view, in the case of bilateral aid, absorptive capacity constraints facing some developing countries could stand in the way of increased aid flows and call into question the appropriateness of sudden increases in aid flows. With UK ODA being increasingly targeted on a limited number of low-income countries[37], sudden influx of aid into some of the countries concerned could cause difficulties. In the short-term, it is advisable for the UK Government to channel part of the increased ODA through EU institutions, UN agencies like the ILO, WHO, UNDP etc in order to minimize the risk of absorptive capacity constraints in some target countries. The TUC hopes that the UK Government will reconsider its decision to withdraw financial support for the ILO and make contributions to the implementation of ILO Decent Work programmes at country level[38], for instance.
21. There is also scope for the DFID to support development cooperation activities by trade unions and/or enhance the effectiveness and impact of its own interventions through close collaboration with the trade union movement in the UK and abroad. Many development agencies[39] and ministries of foreign affairs[40] in the EU are keen to exploit the potential, engage with trade unions

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[32] A view supported by DAC Peer Review 2010, "Where it engages in middle income countries (MICs) such as India, the UK should sustain its focus on poverty reduction.", p16

[33] The UK Government, following the MAR, decided to limit the number of multilateral institutions through which it channels ODA and concentrate it on fewer of them.

[34] Overall, fifteen of the forty-three multilateral organisations were judged to be strong in performing a role which is critical to meeting UK development and humanitarian objectives, and twenty-one were deemed to be satisfactory. This is a very strong endorsement of the central importance of the multilateral system for meeting UK development and humanitarian objectives, MAR, Para 15, Chapter 3

[35] The DAC Report on Multilateral Aid in 2008 enumerated the advantages of the multilateral system.

[36] The 0.7% Aid Target, Standard Note, SN/EP/3714, 17 Sept 2012

[37] Following the Bilateral Aid Review in 2011, the DFID decided to reduce the number of countries from 43 to 27 in the coming years.

[38] [38] http://www.tuc.org.uk/tucfiles/394/A_Decent_Job.pdf

[39] Social Dialogue and Workers' rights, The Right to a Better Life, DANIDA, June 2012

[40] http://www.fnvmondiaal.nl/media/pdf/352260/1194602

in policy dialogue and support trade union development cooperation initiatives in a variety of ways.

What lessons can be learnt from other national donors?

22. We appreciate the UK's standing in the international donor community, not only as a significant contributor to ODA, but also as a leading advocate of aid effectiveness, as well as its influence in shaping the development agenda. The UK also plays an important role in the provision of humanitarian assistance and in engaging with fragile states and is often viewed as a model by other donors[41]. Nevertheless, the TUC believes that there is room for improvement in the following areas.
23. As pointed out before, the UK has not yet taken the opportunity to enhance the impact of its aid programmes through engagement and collaboration with trade unions in developing countries, despite its recognition of the role of labour in development. Apart from a few sporadic examples, the DFID has shown little interest in supporting UK trade unions in their development initiatives. There is scope for the DFID to help develop sustainable capacity in trade unions in developing countries to enable them to play a catalytic role in promoting democracy, good governance, the rule of law etc. In general, as the DAC Peer Review points out[42], the DFID has often construed capacity in the context of state capacity and accountability and missed the opportunity to develop capacity in civil society, especially, non-state actors like trade unions capable of holding the State to account. The DFID should learn from the experience of its DAC partners – Denmark, Finland, Germany, the Netherlands, Norway, Spain and Sweden, in particular – who have consistently provided substantial support for trade unions[43] and other non-state actors to effectively fulfil their role as partners in development.
24. The TUC is aware of the Government's intention to improve predictability of ODA in terms of volume over a reasonably long period of, at least, 3-4 years. In this regard, the TUC is disappointed that the Government took no meaningful initiative to adopt the private member's bill to enshrine the commitment to devote 0.7% of GNI in legislation in March[44] this year. The Danish ODA has exceeded the 0.7% of the country's GNI in the last 30 years. The predictability of aid in Denmark is, according to DAC[45], assured by the publication of aid figures under the Finance Act and their inclusion in bilateral agreements and the 3-5-year disbursement plans made public in advance.

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[41] See The DAC Peer Review of the United Kingdom, p13, 2010

[42] "The UK's development policies are relatively strategic in their approach to capacity development; however, neither the UK government nor DFID has articulated a clear or explicit vision for capacity development in the context of UK development co-operation.", DAC Peer Review of the United Kingdom 2010, p20

[43] In 2012, a comprehensive study of 25 trade union recipients of financial support from development agencies in 18 countries concluded that "*TUs should be seen as development actors in their own specific right, and should not be limited by the same uniform requirements for short-term impact indicators, geographical concentration and thematic focuses as for other CSOs*.", Trade unions' views on working with donor governments in the development sector - A review of 18 donor governments' support mechanisms, TUDCN Development Papers, 2012/4, p45

[44] In February 2013, in a letter to the Secretary of State for International Development, the TUC urged the Government to ensure the adoption of the private member's bill

[45] DAC Peer Review of Denmark 2011, p.15

25. The DFID, like DANIDA, has decentralised its work and reduced staff in recent years and is likely to face the adverse consequences of loss of expertise and experience in the delivery of aid and in ensuring aid effectiveness. In our view, the DFID will find it hard to guarantee the quality of its ODA if it continues staff reductions. The development of knowledge and skills of existing staff is a priority and can benefit from the Danish experience[46].
26. The UK Government needs to translate into reality its long-standing commitment[47] to ensure policy coherence across all departments, notably, the FCO and Department of Business, Innovation and Skills, Department for Environment, Food and Rural Affairs. In our view, all donors including non-DAC donors need to ensure that the aims and objectives of ODA are shared with, and supported by, other organs of government and progress in this regard is long overdue.
27. The DAC has published a series of publications distilling best practice from peer reviews of donors which covers a broad range of themes[48] including partnerships with civil society, capacity building, effective aid management etc. The UK Government, notably, the DFID needs to take into serious consideration DAC advice in these areas.

How should DFID monitor and influence expenditure by multilateral institutions, including in countries and regions where DFID does not have bilateral programmes?

28. Multilateral institutions have grown in number[49], diversity and complexity over the years. The UK needs to concentrate on the institutions through which it channels a significant proportion of its multilateral aid and monitor their performance and exercise influence on the expenditure of those critical to the achievement of its ODA aims and objectives[50].
29. The UK has at its disposal a range of mechanisms to conduct *ex-post* assessments[51] of multilateral aid at different levels in addition to specially commissioned periodic reviews and access to evaluations of multilateral aid carried out by other agencies and should take into account their recommendations and put in place adequate and appropriate arrangements for monitoring expenditure by multilateral agencies.
30. As for *ex-ante* appraisal of interventions by multilateral agencies, the UK has adequate representation on the decision-making organs of the majority of

[46]The Danish Ministry of Foreign Affairs should "*Review its human resource policy, its staffing levels and strategy for recruiting specialists, and its training plan for headquarters and embassy staff to ensure they can effectively implement the new strategy, especially in light of the focus on fragile states," recommends DAC Peer Review 2011, p18,*

[47] "Our government will work together as one. We created the Department for International Development in 1997, not to confine development, but rather to make sure it had enough influence across all our choices – whether in diplomacy, trade or security strategies.", Secretary of State for International Development, Eliminating World Poverty: Building our common future, DFID White Paper, 2009.

[48] See, for example, *Partnering with Civil Society, Supporting Partners to build their Capacity, Managing Aid: Practices of DAC member countries*

[49] According to the OECD, there are about 210 major organisations and funds. MAR commissioned by the UK Government included 43 of them.

[50] See terms of reference of MAR

[51] National Audit Office, International Development Committee, Independent Commission on Aid Impact, for instance

multilateral institutions– WB[52], IDA, EU, regional development banks, in particular, to which it provides substantial amounts of aid as core funding[53], and should be in a position to have an oversight on the design, implementation and monitoring of projects and programmes funded by them.

31. DFID offices should consult, and engage with, trade unions and other civil society groups and get feedback not only on UK bilateral interventions, but also on multilateral action carried out through EDF, World Bank, IDA and other agencies in order to gauge the impact at grass-root level. Moreover, DFID officials dealing with UN specialised agencies – UNESCO, for instance, should work in close collaboration with Education International – Global Union in the sector - in order to enhance the effectiveness and impact of their action.
32. The UK, being one shareholder among others, needs to collaborate closely with other contributors to multilateral institutions in order to increase the effectiveness of multilateral aid. In fact, separate reviews[54] of multilateral aid by individual donors such as the UK constitute administrative burdens and costs on multilateral institutions. In addition, it is hard to carry out a rigorous, objective, impartial evaluation of a large-scale intervention funded by the World Bank from the viewpoint of a single shareholder alone. The UK should persuade other shareholders to undertake joint evaluations of their contributions to multilateral aid. In addition, the UK should support reforms of multilateral institutions ensuring more involvement of developing nations in their decision-making processes. Finally, the UK needs to adhere to its commitments to enhance aid effectiveness[55].

June 2013

[52] The voting rights in WB and IMF are determined by a country's share in the capital which entitles 78,550 votes, for example, in the WBG. UK has 1,212,241 votes in the IDA.

[53] 70% of core funding by the UK went to EU and multilateral development banks in 2011-12. The use of funds provided as core funding is at the discretion of the management in line with the aims and objectives agreed by members.

[54] Since MAR, four countries – Australia, Denmark, the Netherlands and Sweden – carried out separate reviews of their multilateral aid.

[55] Paris Declaration on Aid Effectiveness (2005), Accra Agenda for Action (2008) and Busan Partnership for Effective Development Cooperation (2011)

Written evidence submitted by Adam Smith International

1. Quantity and quality of UK aid spending

1.1 The debate over the quantity of the aid budget seems largely to be coming to an end, now that the 0.7 target has been reached. It is natural that the debate will now move from the quantity of aid spending to its quality. This is a healthy shift.

1.2 0.7 represents a modest part of total UK public spending and the sum is not huge when compared to public needs in the developing world. In the form of simple resource transfer, UK aid will not make a huge difference to the lives of poor people in the developing world. This remains true whether it is 0.8%, 0.5% or 1% of GDP. Total public spending in India, just one country in receipt of UK aid funds, is some £70 billion, many times the total global UK aid budget.

1.3 It is only by using our aid resources in a transformative way that we have the ability to make a significant impact. UK aid needs to achieve the maximum leverage for every £1 spent. We can really only reduce poverty by helping transform the economies and societies of developing countries to achieve fast economic growth supported by effective governance. Of course there is an important role for humanitarian aid and on occasion other resource transfers. An effective development programme needs to use a variety of instruments. The main focus, however, should be on directing aid spending to the areas providing the best value for money and the highest return on investment.

1.4 This implies that it will be difficult to justify many straightforward resource transfers such as budget support, which is in any case difficult to track because of the absence of effective independent audit institutions in recipient countries. £1 of budget support buys £1 of public services (less transaction costs, waste etc.). It is possible to have a much higher return on investment.

1.5 Care of course must be taken not to direct aid only into those programmes that are easy to measure. For example, improvements in governance are critical but more difficult to measure. The answer is to put more effort into measuring such programmes. Such measurement is a common feature of domestic spending initiatives in OECD countries, where return on investment for justice and security initiatives, for example, is frequently calculated.

2. Development Finance

2.1 We are not convinced that it is good policy to establish another development bank. There are already a considerable number of these bodies and we doubt whether another one is really needed. Indeed the BRIC countries are already committed to establishing a new development bank. Development banks tend to be slow and risk-averse, usually ending up lending lots of money to governments. As with any institution that lends other people's money to other people, quality is often not very high. Process becomes the most important thing.

2.2 It would be worth considering more innovative solutions. For example one could encourage direct investment by UK citizens in private sector firms in developing countries. One option, put forward by Adam Smith International in a research paper for DFID, would be to encourage the creation of new institutions to enable private investors to invest in developing countries. We called these 'Development Resource Trusts,' (DRTs). DRTs, dedicated to channelling private savings from the UK into the equity of companies in designated low-income countries, could help to overcome the equity gap in low income countries.

2.3 Tax incentives would encourage private investors to invest in these vehicles. They could be expected to result in a significant increase in interest on the part of ordinary investors in Britain in poorer developing countries.

2.4 Given the high levels of risk involved, tax incentives would have to be significant. They would have to be at least as generous as those pertaining to Venture Capital Trusts in the UK and likely more resemble those available for the Seed Enterprise Investment Scheme (50% income tax relief and no CGT on disposal). The cost of tax relief would be counted as official development assistance and would be attributed to the DFID budget. The cost of the tax relief would likely be less than the administrative costs of establishing and running a new development bank.

2.5 The use of a specific vehicle such as a DRT would enable DRT managers to offer investment expertise to retail investors. However another approach would be to provide the tax relief to any qualifying investment in a small company in the developing world. Entrepreneurs from those countries or their partners in Britain could then use crowd-sourcing techniques to raise funds. These are increasingly successful in attracting angel investors to domestic start-up projects in the UK and would be well-suited to raising investment for projects in the developing world.

3. Multilateral aid

3.1 The question is posed as to whether DFID has the right balance between bilateral and multilateral aid. In our view spending is currently weighted too heavily towards multilateral aid. As we describe below, multilateral organisations are relatively inefficient and not particularly accountable. It is difficult to identify clearly the results delivered by many of their programmes.

3.2 There is thus an increasing divergence between DFID's bilateral programme, with its increasing emphasis on results, value for money, and accountability to the taxpayer, and DFID's multilateral spending. We doubt that it is viable to have two distinct parts of the aid programme, - a high-performing, accountable bilateral one and an inefficient, unaccountable multilateral one.

3.3 The playing field between multilateral and bilateral aid is not an even one. There are strong non-merit-based incentives to channel funds through multilateral organisations (e.g. avoiding in-house administrative costs and getting money out the door to meet budget targets). These incentives should be removed and the playing field made level so aid allocation decisions are made on a clear merit basis. Below we discuss the performance of various multilaterals and put forward suggestions for these policy changes.

UN organisations

3.4 Of all the multilateral organisations to which DFID gives funds, the UN ones are the most problematic. While the central UN political functions play a valuable role the same cannot be said of many of the various subsidiary organisations. Of these we are most familiar with one of the largest, the United Nations Development Programme (UNDP). We conducted an evaluation of UNDP's work in Somalia, which had been financed by DFID and a variety of other donors. We found that while it seemed of poor quality and ineffective it was actually impossible to judge since due to the absence of information no coherent conclusions could be drawn as to results achieved.

3.5 As part of this evaluation we conducted an assessment of other UNDP projects in order to determine whether the problems were systemic. We looked at 30 evaluation reports. A very common feature was the full or partial inability to measure results. In most cases there was no clear

baseline from which to measure progress, reporting focuses on activities rather than outcomes and there are few if any measurable indicators. Other common features include:

- Complex bureaucratic procedures which cause extensive delays in implementing project activities
- Poor and incomplete financial reporting with a lack of financial transparency
- Poor project design, often over-ambitious with unclear objectives
- Inefficiency and ineffectiveness in project implementation

3.6 The evidence suggested that UNDP is focussed on resource mobilisation rather than the achievement of results. After discussion with DFID we looked at 16 further evaluations subsequent to May 2011, to determine whether improvements had taken place after the initial MAR exercise had been completed. They had not.

3.7 These conclusions are not surprising. Indeed they are echoed by analysis prepared for the UNDP's own board. Take for example this conclusion of an internal evaluation of UNDP's contribution to poverty reduction, considered by the UNDP Board a few months ago in February 2013 (our underline):

> "The contribution of UNDP interventions to national poverty outcomes is seriously compromised by the absence of adequate support to learning from its interventions about what works and why. This in turn is caused in large part by the absence of a structure of incentives that would encourage systematic collection, monitoring and evaluation of evidence on the actual changes in people's lives as a result of interventions. The fact that UNDP is nevertheless weak on learning stems from two main factors (as identified by numerous evaluations). First, quite often the results are defined in terms of inputs or outputs rather than final outcomes in terms of impact on poverty in its multiple dimensions. In consequence, not enough information is generated on the relevant outcomes that would help the office to learn what works and what does not for poverty reduction in particular contexts. Secondly, whatever information exists on results is not systematized and distilled into forms which others – both within and outside UNDP – can subsequently use for designing new and more effective programmes for poverty reduction. At the same time, the tendency of UNDP country programmes to spread themselves thin adds to the transaction costs that are inevitably associated with learning."

3.8 It is difficult to understand in these circumstances why UNDP was rated 'good' and 'satisfactory' in DFID's multilateral aid review and why it continues to receive large amounts of funds from DFID. One explanation is that the terms of reference for the review gave positive points to those agencies which were present in DFID's priority countries, as UNDP undoubtedly is. But being present is far from the same as delivering results. Another explanation is that giving money to UNDP and other UN agencies involves much less hassle than putting it through a full competitive process and allows money to be spent quickly. There is also the 'not being fired for buying IBM' factor, with UN being substituted for IBM. And since it is very difficult to establish whether anything is achieved or not, because of the poor impact measurement discussed above, the prospect of there being controversy about waste is pretty remote.

3.9 Another factor which explains the continued transfer of UK resources to UN agencies is the idea that this somehow helps 'reform' them. In essence UN agencies are treated as if they are badly run developing countries in need of special assistance. They continue to be given funds in the expectation that they will reform, although they don't. In fact it is a positive advantage for the UN agencies not to be able to measure their impact. It means that they can't be held to account. The primary conclusion of our evaluation of UNDP's work in support of governance and rule of law in Somalia was that it was not possible to tell the extent to which progress had been made towards outcomes. When we presented this conclusion to the UNDP Country Director he suggested that we should ask the donors to provide help to UNDP to get better at measuring impact. To be frank, such suggestions are at best misleading. UNDP is a huge global development agency with an annual budget of over $5 billion. If it can't itself learn how to measure impact – scarcely rocket science – then it shouldn't be in business at all.

3.10 UN agencies do not favour being subjected to competition. In Somalia a prominent UN representative recently stated that the UN should be exempt from the need to bid competitively, and that it should not be restricted from awarding resources non-competitively to other parts of the UN as the organisation was not tied to the normal definition of conflict of interest. In an earlier report on Nigeria, which criticised the poor performance of UNICEF, the Independent Commission on Aid Impact (ICAI) raised the question of whether DFID should contract UN organisations as implementers on a non-competitive basis. It is clear that the performance of these organisations is not so strong that they should be given major tasks on a non-competitive basis.

Multi-donor trust funds (MDTFs)

3.11 Multilateral organisations are frequently put in charge of MDTFs. Such funds are frequently set-up by donors in conflict-affected countries. Money can be disbursed quickly, even though it may not actually be used for any development purpose for several years. Funds sent to multilaterals are considered 'spent' in accounting terms as soon as they are received by the multilateral. This means that DFID can quickly transfer funds to multilaterals to meet spending commitments.

3.12 However, the record of multilateral organisations such as UNDP and the World Bank in running such trust funds is poor. As a report on Evaluation of UNDP support to conflict-affected countries that was presented to the UNDP Board in January 2013 itself frankly commented:

> "UNDP manages multi-donor trust funds in many conflict settings. The management of these funds has encountered some criticism with respect to high overhead charges, slow disbursement and the perceived preferential treatment given to the organization's own development support programmes."

3.13 As this report finding suggests, all too often the MDTF system is used to feed the UN itself as one of the highest priorities. UN agencies like to allocate resources to other UN agencies. Indeed they are expected to do so by the UN system. If we take the UNDP-run trust fund for Iraq as an example, the funds were first disbursed to UNDP. Then UNDP split up much of them between various UN agencies. Then the respective UN Agency would often hire UNOPS, (the UN Office of Project Services) to implement a project. Then UNOPS would often hire an international NGO, who would often hire a local NGO, who then would finally do something, which usually couldn't be

monitored and evaluated because it was too dangerous to do so. Of course each of the above bodies in the four-level chain would extract its management fee, adding greatly to unproductive costs.

3.14 World Bank-run MDTFs also suffer from similar problems. MDTFs are popular with the Bank, who look after some 500 of them, not least because they enable World Bank teams to supplement their administrative budgets. They are often subject to considerable procedural complexity and delay. The Sudan MDTFs are some of the most notorious examples of such delay, with funds not being spent for years, despite the urgent needs on the ground. ODI commented that "these World Bank-administered funds were supposed to ensure coordinated external donor support.... In practice, they have failed to achieve visible impact . The rate of disbursement has been excruciatingly slow.....Bureaucratic World Bank procedures, staffing problems and protracted negotiations on who does what hindered initial implementation.."

3.15 Research just published by DFID (Pooled Funding to Support Service Delivery : Lessons of Experience from Fragile and Conflict-Affected States, May 2013), while noting the theoretical arguments for MDTFs, casts some doubt on their practical application. It lists some of the disadvantages as follows:

- "Complexity: They often produce complicated implementation arrangements.
- Cost: Despite promising to cut costs, MDTFs are often more expensive in practice.
- Persistent front-loading: In some circumstances (particularly countries of high geo-strategic importance such as Iraq and Afghanistan) pressure to distribute funds quickly can lead to poor standards of implementation, weakening aid effectiveness and contravening state-building objectives.
- Slow disbursement: In other contexts, MDTFs can be slow to disburse funds in practice".

The European Union

3.16 The UK funds a number of EU aid programmes, most of them compulsorily through the EU budget but one major one, the European Development Fund (EDF) relies on voluntary contributions from member states, including the UK. It is difficult to get to the bottom of whether these EU programmes perform effectively, as evaluation reports are not independent and are rather opaque in nature. It is notable that ICAI concluded in its review of 'DFID's Oversight of the EU's Aid to Low-Income Countries', "weaknesses in the EU's own performance management and results framework make an overall view of the impact of EU programmes difficult to achieve." ICAI further concluded that "DFID's oversight does not provide the assurance needed, given the substantial scale of the UK's contribution and the limited discretion the UK has about the EU as a route for aid".

3.17 Some independent analyses of EU aid spending are carried out by the EU Court of Auditors and these are generally not very complementary. For example a recent report criticised the EU Commission's expenditure of £6.1 billion on roads in sub-Saharan Africa because the Commission failed to ensure that recipient countries actually maintained the roads or enforced weight limits, leading many of them to fall into disrepair. In another report on 'European Union development assistance for drinking water supply and basic sanitation in sub-Saharan countries' the Court of Auditors concluded that the majority of projects were unsustainable.

3.18 The EDF favours budget support as an aid modality. It is doubtful that the UK would provide budget support to many of the same countries, as the level of corruption and mismanagement of public finances there would likely provoke considerable public disquiet. Under the 10th EDF, 54 % of budget support is targeted at 9 countries (Mozambique, Tanzania, Burkina Faso, Ethiopia, Zambia,

Madagascar, Niger, Mali and Ghana). Several of these countries are characterised by very high levels of corruption.

The World Bank

3.19 The World Bank was rated favourably in DFID's Multilateral Aid Review and receives considerable funds from DFID. While the Bank indubitably has many technical staff of high quality there are very substantial problems with its modus operandi for the implementation and oversight of its programmes. There are often huge delays in its programmes, such that one has usually no real idea when they will start. To take one example, in 2008 DFID agreed with the World Bank to launch a joint programme in Nigeria called GEMS to help remove barriers to economic growth. DFID was to fund and manage some components and the World Bank others. The DFID components started being implemented in 2009. The World Bank components have yet to start, five years later. It is possible that the DFID components will actually have finished before the World Bank ones start, if they ever do.

3.20 A key part of the problem is that the World Bank is set up as a bank. This places considerable restrictions on how it operates. A former senior World Bank official who has subsequently worked with us has described the problem thus:

> "Many of the Bank's problems stem from its Human Resource issues. Staff personal incentives are not necessarily aligned with development effectiveness or efficiency. Bank staff are very concerned with their own job and justifying it....The Bank HR system does not incentivize risk taking and innovation in the lending operations, but does in the knowledge research area. There should be recognition of this – that although you can't see the direct impact on the ground level as clearly, the knowledge part of the Bank is still very good and needed, but Bank management is over focused on the lending numbers".

Monitoring the expenditure of multilateral institutions

3.21 The Committee is concerned as to how DFID can monitor and influence expenditure by multilateral institutions more effectively, especially in countries and regions where DFID does not have bilateral programmes. This is indeed a challenge, as highlighted in our analysis above. Even in countries where DFID has a presence, it can be quite difficult to find out what is going on. One solution is to require the respective multilaterals to be more open with programme information. However, nothing beats sending in an independent team to conduct a proper, detailed independent evaluation.

3.22 HMG should negotiate with multilateral organisations to which the UK provides funds on a voluntary basis to permit full access by ICAI to all programme information and financial data, in the same way that it has access to information about programmes directly funded by DFID. If after a period those multilateral organisations do not agree to provide this access then the UK should provide only core, compulsory funding.

3.23 The Development Select Committee should direct ICAI to undertake in-depth reviews of programmes conducted by multilateral organisations. Some of these should focus on countries and regions where DFID does not have a bilateral programme.

3.24 The UN is currently responsible for selecting and reporting to donors such portions of audits as the UN sees fit, often several years after the transfer of funds or the completion of activities. This means that difficulties in implementation or management are hard or impossible to spot and thus address. This is not helped by the rotation of donor staff who may be unable to correlate reporting with the justification for a project in the first place. The UN incorporates resources from programme funds to undertake evaluations of activities. These are not always routinely or widely shared outside of the UN or donors leaving the potential for a great deal of experience to be lost to the wider development community. Greater availability of internal and external reporting would also provide scrutiny that would drive accountability and allow strengths and weaknesses to accurately be identified and addressed. DFID should make it a stipulation of funding that UN evaluations should be made fully and freely available in a timely manner to allow challenges to be addressed in an effective timeframe and to share relevant and up to date lesson learning with the wider development community. DFID should also stipulate that the UN system should publish full and as near to real-time audits of DFID funded programmes and make them publicly available.

Other suggested policy changes towards multilateral spending

3.25 The accounting treatment of funds given to multilaterals should be revised in order to remove one inappropriate incentive for funding them –in order to meet budget targets. DFID should change its accounting policy so that DFID money spent by multilaterals and trust funds is only counted as spent at the time when it is actually spent on the ground, not when it is transferred into the bank account of the multilateral.

3.26 It is not appropriate to fund multilaterals with high administration costs at a time when DFID's own administration costs are being cut. The current system provides a perverse incentive for more money to be spent on administrative costs, rather than less. The administrative costs of most multilaterals, as highlighted by the Committee in its recent DAR report, are way above those of DFID. The result is that DFID spends more on administration by funding multilaterals, the direct opposite of the original policy objective.

3.27 DFID's administration costs should be redefined to include the proportionate administration costs of multilateral organisations to which it gives funds. Thus if DFID gave £1m to a multilateral with administration costs of 7% then £70,000 should be added to DFID's administration costs. At the same time the cap on DFID's own administration costs should be lifted from the current 2% to some 3% or 3.5%. If there is a concern about adding to permanent civil service numbers then perhaps a cap on permanent civil service staff in DFID could remain, while the number of contract staff it can employ in administrative functions should be able to increase until the administrative costs cap is reached.

3.28 DFID should not retain multilateral organisations that directly implement, e.g. UNDP and UNICEF, on a non-competitive basis. They should always have to compete with others before being awarded work to carry out programmes.

June 2013

Written Evidence Submitted by Oxfam GB

1. Introduction

1.1 Oxfam welcomes the opportunity to submit evidence to International Development Select Committee's inquiry on development finance at a time when the UK Government needs to articulate a clear vision and a 'road map' for UK development assistance. This submission covers:

- **0.7 target:** To fulfil its international obligation the UK must continue to provide at least 0.7% of Gross National Income (GNI) as Official Development Assistance (ODA) to reduce poverty and inequality;
- **Financial instruments:** Currently DFID does not use its range of financial instruments as effectively as it could. DFID should carefully select the most appropriate financial instrument based on the unique project purpose and country needs. Any loans provided by DFID should be additional to the 0.7% ODA commitment;
- **Climate finance:** Climate finance must be additional to the 0.7 ODA target;
- **Development Finance Institution (DFI):** DFID would need to make a convincing case to demonstrate the added value of a new DFI;
- **Bilateral and multilateral aid:** Whilst Oxfam supports bilateral aid, aid delivered via multilateral organisations can address global problems and provide support for global public goods that cannot be tackled by bilateral funding;
- **Lessons from other national donors:** DFID can take lessons from other donors on aid effectiveness and domestic resource mobilisation. It is also vital that DFID listens to country stakeholders including local officials and citizens;
- **Monitoring and influencing expenditure by multilateral institutions:** DFID should ensure that the multilateral organisations selected follow the OECD guidelines for ensuring effective aid.

2. How appropriate the 0.7% ODA target will be in the long term

2.1 Oxfam believes that developed nations should fulfil the United Nations (UN) commitment to spend at least 0.7% of GNI on ODA[1]. We welcome the UK's leadership in delivering this long-standing commitment – a move that consolidates the UK's position as a global leader on international development policy.

2.2 Poor countries lost $140bn in budget revenues due to the global economic crisis[2]. As a result of aid coming too little and too late to fill this fiscal hole, 40% of extra spending by developing countries has been funded by borrowing and risky off-budget private financing initiatives. For all targets most developing countries' spending on Millennium Development Goals (MDGs) has been well below the amount promised, or international organisations' estimations of the

[1] UN Document: 2626 (XXV). International Development Strategy for the Second United Nations Development Decade http://www.un-documents.net/a25r2626.htm

[2] Based on actual revenues compared with levels forecast by the IMF before the financial crisis hit. Government Spending Watch, May 2013, http://www.governmentspendingwatch.org/images/pdfs/GSW_Report_2013/Executive_Summary_GSW_Report_2013.pdf

amount needed[3]. To date progress on meeting the MDGs has been uneven within countries and regions with much of the progress a result of success in relatively easier 'low-hanging fruit'[4].

2.3 For the second year running aid levels have fallen, and donors' failure to deliver on their aid promises will have drastic implications for the likelihood of reaching the MDGs. Projections indicate that in 2015 almost one billion people will be living on an income of less than $1.25 per day[5]. Meeting all MDG targets, including the harder to reach people will be a challenge that will continue beyond 2015. Therefore **the UK must commit to providing at least 0.7% of GNI in aid as long as it is needed.**

2.4 Oxfam recognises that ODA flows are relatively small as a proportion of total financial flows to developing countries, but for many countries aid is necessary to maintain public spending; in the mid-2000s Ghana, Tanzania and Uganda financed between 36 and 70% of expenditure with aid. Crucially, ODA remains the only source of funding for development that is solely focussed on tackling poverty. This poverty focus has been safeguarded by the OECD Development Assistance Committee's (DAC) definition of ODA, stipulating that the main objective of ODA is the promotion of the economic development and welfare of developing countries.

2.5 ODA – particularly though multilaterals - has a key role in promoting global public goods and providing financing capacity to address social and economic problems. Aid from national donors that is used to build the human capital of recipient countries acts as a catalyst for poverty reduction, supports effective state institutions and provides resources to help an active population hold their governments to account.

2.6 Given that around 80% of poor people now live in middle income countries (MICs) [6], it is crucial that donors continue to provide ODA to MICs to tackle poverty and inequality, achieve the MDGs and reach the poorest people where their basic needs are unmet by the government or market. This does not absolve MIC governments of their responsibility to pursue redistributive policies to tackle poverty and inequality, but **while extreme need exists in MICs DFID should provide aid whilst working more with national governments to tackle poverty and inequality.**

3. DFID's financial instruments

3.1 Does DFID have the right mix of financial instruments?

Different financial instruments are required in different contexts; DFID should select the most appropriate financial instrument based on the project purpose and country needs, whilst retaining a strategic focus on poverty reduction. DFID must take measures to avoid increasing states' indebtedness, therefore extra caution should be taken in providing loans.

[3] Only one third of the 52 countries assessed are meeting promised or needed levels on health, one-quarter for education and one-fifth for agriculture and water, sanitation and hygiene, Government Spending Watch Report 2013, Development Finance International and Oxfam, http://www.governmentspendingwatch.org/research-analysis/latest-analysis/51-mdg-spending-in-developing-countries.

[4] The MDG and 2 sub-goals met to date: halving extreme poverty, halving the proportion of people without access to improved source of drinking water and significantly improving the lives of at least 100 million slum dwellers: UN MDG Report 2012, http://www.undp.org/content/undp/en/home/librarypage/mdg/the-millennium-development-goals-report-2012/.

[5] The Millennium Development Goals Report 2012, United Nations http://www.un.org/millenniumgoals/pdf/MDG%20Report%202012.pdf

[6] Sumner, A (2012) Where will the world's poor live? IDS In Focus Policy Briefing Issue 26

3.1.1 Budget support:

3.1.1.1 The World Bank calculated that countries that received debt relief – essentially a form of general budget support as it frees up money in the national budget – increased investments in poverty reduction from $6bn in 2000 to $17bn in 2006[7]. The European Commission also found aid recipients with higher levels of budget support performed better on a range of development indicators to those with lower levels of budget support[8]. Budget support is more predictable and enables partner governments to increase expenditure in their priority areas and align funding with their national development plans, bringing greater ownership and improving a government's accountability to its own citizens. Despite the positive impact of budget support, in 2011 DFID announced that budget support would be cut by 43%; large reductions in general budget support have only partially been compensated by sector budget support.

3.1.1.2 Budget support (general, sector, or a combination) is an effective financial instrument where governments have a strong commitment to fighting poverty and upholding human rights; reasonable financial systems to account for the use of resources; and mechanisms in place to ensure the availability of basic information to its citizens. Oxfam believes that **DFID should reverse this decline in its use of budget support.**

3.1.2 Technical cooperation and assistance: In some circumstances technical assistance can be an appropriate instrument for example in enabling governments to learn from others' experience; however recent scandals over the poor targeting of technical assistance and accusations of money wasted have revealed the problems with technical assistance. A recent investigation by the Independent Commission for Aid Impact on DFID's use of contractors identified the importance of strong stakeholder support as a key ingredient of a project's success[9]. **DFID must ensure that there is always national ownership of the development process and buy-in from stakeholders.** Additionally, **DFID could improve the effectiveness of technical assistance by fully untying technical assistance** to use local and regional procurement systems as per the Accra Agenda for Action[10]. This would place developing countries in control of technical assistance funds, enabling them to decide whether to hire local or other consultants[11].

3.1.3 Civil society: DFID should continue to fund civil society organisations (CSOs), complementing other aid instruments and empowering citizens to hold their governments to account. Strategic, flexible funding like the Programme Partnership Agreement enables CSOs to operate more effectively and efficiently, develop innovative programmes that better meet the needs of poor people, respond rapidly to emergencies and work in risky fragile settings. Alongside project grants and service contracts **Oxfam encourages DFID to continue to provide strategic flexible funding to CSOs in the future.**

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[7] IDA/IMF (2007) 'HIPC/MDRI Status of Implementation Review', 28 August 2007.

[8] Budget Support and MDG Performance, March 2010, European Commission, http://www.gopa.de/uploads/media/budget_support_MDG_performance_development_paper_en.pdf

[9] DFID's Use of Private Contractors to Deliver Aid Programmes, ICAI, May 2013

[10] Accra Agenda for Action http://www.effectivecooperation.org/files/resources/Accra%20Agenda%20for%20Action%20in%20Brief%20ENGLISH.pdf

[11] For more details on local procurement see Eurodad's report, by Bodo Ellmers 2011: How to Spend It: smart procurement for more effective aid http://eurodad.org/uploadedfiles/whats_new/reports/eurodad%20-%20how%20to%20spend%20it.pdf

3.1.4 Blending: given the current economic climate and the value for money agenda there is a growing trend among donors to 'blend' ODA with private funds to leverage private finance for development purposes – often in the form of subsidised loans. However financial intermediaries at present are unable to track or evaluate the social impact of their intervention and there is a lack of transparency of their selection. **Until DFID can demonstrate that blending can deliver on development and poverty reduction results in line with national development plans and aid effectiveness principles the UK should not invest in blending.**

3.1.5 Public-private Partnerships (PPPs): Assessing the effectiveness of PPPs is challenging firstly as it is difficult to identify from DFID's database which projects are PPPs and secondly because the level of scrutiny in reporting impact is weak. **DFID must make some fundamental changes in PPP contracts:**

- **Financial flows must be transparent and accountable to both donor and beneficiary - commercial confidentiality must not apply;**
- PPPs should only be used where funding would be not otherwise be commercially viable and where long-term development impact can be ensured;
- The partner selection process must be public and transparent and the recipient country – including its citizens – must be actively involved in the selection.

3.1.6 Other financial aid: DFID should continue to explore other financial aid instruments that deliver aid on budget. These would help improve partner countries' financial management and accountability systems to increase ownership and long-term sustainability and reduce transaction costs.

3.1.7 Humanitarian assistance: Oxfam believes that the best way to support fragile states is through an integrated approach which promotes accountability of all actors and respect for humanitarian principles in provision of humanitarian aid. **DFID should continue to provide a steady commitment to humanitarian assistance.** To facilitate rapid emergency response, **DFID should allocate a proportion of its humanitarian/ emergency funds directly to NGOs including local NGOs and community based organisations** that are well placed to implement emergency programmes including in remote locations.

3.1.8 Debt relief: The UK should continue to provide debt cancellation to poor countries but **Oxfam is opposed to the inclusion of debt relief in reporting ODA figures.**

3.2 The balance between loans and traditional grant aid

3.2.1 Loans do not necessarily comply with the ODA definition i.e. *"administered with the main objective of promoting the welfare and the economic development…"*[12], therefore **any loans provided by DFID should be additional to the 0.7% ODA commitment and not used as a substitute for grant aid.** If DFID does provide loans this should be where other forms of finance are difficult to access. There is also a risk that loans may skew funding towards cash-generating and productive sectors such as infrastructure at the expense of national developmental objectives and public goods.

3.2.2 As set out in the International Development Act (2002)[13], the UK Government must ensure poverty reduction is the overarching purpose of British development assistance. Whilst Oxfam recognises the changing donor landscape and the concentration of the poor in MICs, **traditional grant aid will remain essential in both MICs and LICs.**

3.2.3 There is no one-size-fits-all balance between loans and traditional grant aid, and loans may be appropriate in MICs where economic growth should enable the repayment of loans. However, **DFID must apply caution to ensure that loans – even concessional loans - do not increase the indebtedness of countries**. Simultaneously DFID should assist developing countries to manage their public debt.

3.2.4 DFID must ensure that **ODA remains concessional in character** and convey a grant element of at least 25%[14].

4. The role of the UK as a provider of climate finance

4.1 As the UK and other countries scale up towards meeting the $100bn per year commitment by 2020, using aid money for climate finance is unsustainable[15]. In 2010 15% of ODA was counted as climate finance[16]. **New sources of finance must be found to protect recent development gains**.

4.2 Climate change is an additional burden for poor countries, requiring additional resources to tackle it[17]. A failure to deliver new and additional resources – over and above existing ODA commitments – risks diverting essential aid for health, education and other development priorities. **The UK must work with other governments to agree innovative sources of supplementary public finance, such as carbon pricing of international shipping and aviation emissions**[18]**.**

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[12] Is it ODA? OECD DAC, 2008 http://www.oecd.org/dac/stats/34086975.pdf

[13] International Development Act, 2002, http://www.legislation.gov.uk/ukpga/2002/1/contents

[14] Ibid.

[15] Oxfam, The UNFCCC Work Programme on Long-Term Finance, August 2012 http://policy-practice.oxfam.org.uk/publications/the-unfccc-work-programme-on-long-term-finance-238191

[16] The OECD statistics with country breakdowns for climate finance spending are available here: http://stats.oecd.org/Index.aspx?DataSetCode=RIOMARKERS

[17]International, Adaptation to Climate Change: What's needed and who should pay? 2007 http://www.oxfam.org/sites/www.oxfam.org/files/adapting%20to%20climate%20change.pdf

[18] Oxfam/WWF, Out of the Bunker: Time for a fair deal on shipping emissions, 2011 http://www.oxfam.org/en/grow/policy/out-bunker-shipping-emissions

4.3 **The UK must fulfil its commitment to allocate 50% of its climate finance provision for adaptation** to address the significant imbalance in adaptation/mitigation funding globally. **The UK must maintain a strong commitment to provide public finance for adaptation**, because private finance is often unsuitable for adaptation interventions, especially those involving community-based adaptation and basic services that offer little or no commercial return-on-investment.

5. Potential for a new independent DFI to offer concessional loans

5.1 DFID already invests in the private sector through CDC and makes substantial contributions to the vital work of multilateral development banks – an efficient and effective mechanism for channelling ODA and delivering value for money. As yet the added value of setting up an additional DFI is unclear and unconvincing.

5.2 **If a new DFI is established it must deliver a progressive approach to the quality of growth and investment and not assume that benefits will trickle down to the poorest**. It would have to adhere to the following principles:

- **Demonstrate its added value over and above existing multilateral mechanisms and DFIs;**
- Prioritise poverty reduction and development returns over financial returns and have a strong pro-poor development strategy;
- Actively seek to ensure that intended beneficiaries get maximum outcome.

DFID could do this through:

- Identifying indicators of success, including impacts on poverty reduction, pro-poor growth and human rights; and regularly assessing and publicly reporting on performance against objectives, going beyond financial, economic and private sector development performance;
- Fostering responsible business and transparency mechanisms in line with international standards;
- Ensuring it is not involved in, or facilitating questionable investments, such as land grabbing; and avoid investing in any companies that keep their finances in tax havens;
- Basing investment decisions on the development and poverty reduction needs of the country in which it is investing and aligning with national development priorities;
- Establishing and effectively implementing adequate safeguards to uphold peoples' fundamental rights including food, land and water.

5.3 Using scarce public resources for private finance is only worth the risk if it has clear poverty alleviation purposes and proven benefits for the neediest. The World Bank's Independent Evaluation Group found that less than half of the IFC's projects successfully reached the poor[19].

5.4 The Compliance Advisor Ombudsman (CAO) found a lack of transparency and that the IFC is unable to track whether or not investments are causing harm to poor people and the environment, let alone measure whether they bring development benefits[20]. Oxfam is

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[19] World Bank Independent Evaluation Group, Assessing IFC's Poverty Focus and Results, 2011, p.XVIII. http://ieg.worldbankgroup.org/content/dam/ieg/IFC/ifc_poverty_full_eval.pdf

[20] CAO Compliance Audit of IFC's Financial Sector Investments, CAO, February 2013, http://www.cao-ombudsman.org/newsroom/index.html

concerned that the 'financialisation' of aid - especially with respect to infrastructure – has implications for what is funded, and who benefits. Financialisation of aid often results in privatization with the poor being increasingly priced out of access to the infrastructure constructed[21].

6. DFID's balance between bilateral and multilateral aid

6.1 Whilst Oxfam supports bilateral aid, **aid delivered via multilateral organisations can have cumulative lower transaction costs, reduce fragmentation, tackle global problems and provide support for global public goods that cannot be addressed by bilateral aid.** For these reasons multilateralism is central to the fight against poverty and inequality and in the UK's approach to multilateral assistance[22].

6.2 Oxfam supports bilateral funding when it brings added value in diversity of instruments, innovation in policy and practice, and alternative development schemes enabling developing countries to have more and better options to reduce poverty. **It is vital that poverty reduction remains the main strategic goal of UK development policy – through bilateral or multilateral support.**

6.3 Good quality multilateral aid can be a win-win for DFID: ensuring results in the lives of the poorest people, with a lower administrative burden. Where possible **DFID should use its multilateral contributions to help fill the funding gaps** such as the Global Partnership for Education and the European Development Fund. DFID's multilateral and bilateral aid should remain around the current levels.

7. Lessons from other national donors

7.1 DFID must listen to country stakeholders including local officials and citizens. Simultaneously DFID should encourage citizens to demand more from their government.

7.2 Among national donors DFID has demonstrated a leap forward on transparency, however **is lagging behind in other areas of the aid effectiveness agenda such as improving country ownership.** Finland has set a good example in articulating how to improve its aid effectiveness and recognises the importance of continuing to provide ODA in times of austerity. Finland's Development Policy Programme commits to improve the predictability of its development cooperation funding to enable partner countries to implement their development plans, and increase its focus on multilateral organisations and DFIs in a more strategic manner to reduce fragmentation and align activities with the national objectives of partner countries.

[21] More than Brics and Mortar Infrastructure-as-asset-class: Financing development or developing finance? A Critical Look at Private Equity Infrastructure Funds, Nicholas Hildyard, The Corner House, September 2012 http://www.thecornerhouse.org.uk/sites/thecornerhouse.org.uk/files/Bricks%20and%20Mortar.pdf

[22] For further details see Oxfam's submission to the 'UK Multilateral Aid Review', Oxfam GB, August 2010, http://policy-practice.oxfam.org.uk/publications/uk-multilateral-aid-review-126007

7.3 Denmark's progressive strategy for development cooperation recognises that sufficient domestic revenue to finance reform and public services is a prerequisite for development. In line with this DANIDA has committed to ***"strengthen efforts in the fight against tax loopholes, address illicit financial flows and promote fair taxation of natural resources in the world's poorest countries"***[23]. Similarly Norway - a leader in tax and transparency - highlights that ***"more emphasis is placed on the possibilities of developing countries to increase their own revenues by expanding their tax base…"***[24]. Norway supports both governments and civil society in their efforts to achieve effective, transparent tax regimes, for example by working through the Financial Transparency Initiative and Tax Justice Network in Southern countries. Finland supports the efforts of the African Tax Administrator's Forum, a body based in South Africa that provides a forum for sharing best tax practices and tax policy coordination to address issues including tax avoidance by multinational companies.

8. Monitoring and influencing expenditure by multilateral institutions

8.1 DFID should ensure that the multilateral organisations selected follow the OECD guidelines for ensuring effective aid and endorse the Busan Partnership for Effective Development Cooperation, focussing on agencies that promote poverty reduction, accountability, transparency, ownership and results.

8.2 The UK should continue to use its influence within the multilateral development agencies to ensure their governance becomes more democratic and their policies and practices better support poverty reduction, accountability, transparency and ownership, building on progressive approaches shown by agencies such as the European Commission.

June 2013

[23] The Right to a Better Life Strategy for Denmark's Development Cooperation, Ministry of Foreign Affairs of Denmark, August 2012 http://um.dk/en/~/media/UM/Danish-site/Documents/Danida/Det-vil-vi/right_to_a_better_life_pixi.pdf

[24] NORAD's Strategy Towards 2015: results in the fight against poverty, February 2011

Written evidence submitted by Bond and UKAN

A. Introduction

1. Bond is the UK membership body for non-governmental organisations (NGOs) working in international development.
2. The UK Aid Network (UKAN) is a coalition of UK-based development NGOs working together to advocate for more and better quality aid through joint policy, lobbying and advocacy work.

B. Whether the 0.7% ODA target will be appropriate in the long term

3. How long the 0.7% target is needed depends on global progress in addressing development challenges. We believe the 0.7% target will remain relevant in the long term.
4. Aid is the only resource targeted solely at eliminating poverty. Almost 1 billion people still live in poverty. While we aspire to reduce the need for aid, placing an arbitrary limit on how long we will commit to the 0.7% target is unhelpful and sends the wrong signal to partner countries.
5. An assessment by the UN in 2005 found that meeting the MDGs alone would require 0.54% of developed countries' gross national income (GNI) to be delivered in aid, but to comprehensively address global development and poverty challenges requires roughly 0.7% (see Bond/ UKAN briefing paper http://www.bond.org.uk/data/files/Three_reasons_to_support_aid.pdf). Real progress has been made on some MDGs but there is still a lot to do ahead of the 2015 deadline, and beyond. If there is to be an ambitious development agenda post 2015, we will need more not less financing.
6. The European Council has reaffirmed that a key priority for Member States is to respect the EU's formal undertaking to collectively spend the 0.7% target by 2015. As other donors strive to meet the target, the UK should continue to demonstrate global leadership on this agenda.

C. The balance of financial instruments, loans and grant aid and climate finance

7. The current balance of financial instruments is adequate though more thought to the modality of grants is recommended.
8. The focus of financing should continue to be on providing aid for poverty reduction. Any new financial instruments must be assessed against these criteria.
9. Loans may not be the most effective form of aid spending given that they increase debt levels. Any increase in loans must be assessed against the risks - lack of transparency, lack of evidence of impact or very long evidence chains.
10. Loans could potentially be used as counter-weight to other, more pro-cyclical investment flows to flatten out downturns but this should be assessed on a case by case basis and not underpin general policy.
11. The UK has committed £2.9 billion to international climate finance until 2015 through the International Climate Fund. DFID should ensure its climate finance is governed by a pro-poor, participatory approach, in support of renewable technologies through funds with transparent governance structures.

D. Whether the UK should establish a development finance institution to offer concessional loans

12. DFID, and the Secretary of State, have indicated that they are considering creating a new facility such as an investment or development bank to help deliver the vision of "ending aid dependency through growth and jobs".
13. Any decision to establish a development finance institution must be informed by analysis of;
    - Aid effectiveness: The UK committed through the aid effectiveness process to reduce donor fragmentation and increase harmonisation; will the creation of a new finance institution further increase fragmentation? Does the financing build ownership, local capacity and mutual accountability? It is transparent at organisational, country and programme level? How would countries and programmes be assessed as suitable?
    - Duplication: Creating a new finance institution would increase and duplicate administration costs; will this mean a reduction in the percentage of aid going towards poverty eradication? Does this represent value for money?
    - Leverage: A new finance institution would likely divert funds from other institutions; would this result in a reduction in UK influence at more powerful, global financial institutions?
    - Impact: Does the finance institution respect national priorities and ownership of development priorities? Is it adequately focused on results for the poor and most marginalised, including women? How will the evidence and results be measured?
    - Ending aid dependency: Would a financing institution build genuine independence from aid? Aid dependence means countries are dependent on aid to deliver basic government services, often referred to when more than 20 or 30% of a recipient country's budget is funded by ODA. Aid dependency has fallen significantly since 2000. According to a 2011 report (ActionAid – RealAid 3[1]), 14 of the 30 most aid dependent countries reduced their dependence by more than 20% of expenditure between 2000 and 2009. This has been achieved, inter alia, by strengthening county leadership, strengthening accountability to domestic stakeholders and using aid to generate long term and sustainable financing, notably strengthening tax systems. There is no specific reason establishing loans through a British finance institution would increase the potential to end aid dependency.
    - How will DFID ensure projects meet international human rights obligations, equitable access and do not do environmental damage, threaten livelihoods or impinge on land rights?

E. Balance between bilateral and multilateral aid

14. In principle, the allocation between multilateral and bilateral aid (approximately 35% and 65% respectively[2]) seems appropriate given that aid modality and delivery mechanisms are chosen based on the best way to achieve results. However, in practice, the decision is not necessarily as value-free – aid allocations can be influenced by political negotiations around funding rounds for multilaterals, political and other external considerations, historical ties and some degree of national or economic interest even if this does not go so far as tied aid.
15. Given the increasing size of the UK ODA budget, it is more practical to deliver a significant proportion of our aid through multilaterals. While multilaterals are sometimes associated with higher administration costs, this is at a saving on the UK

[1] http://www.actionaid.org.uk/sites/default/files/doc_lib/real_aid_3.pdf
[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/175529/Prov-UK-_ODA-2012-_stats-release.pdf

side as it is ‘cheaper’ to fund multilaterals than attempt to build the necessary infrastructure in a much larger number of countries. Multilaterals are sometimes the most effective, and only, way of delivering aid in places the UK/DFID cannot easily work due to security or political considerations. Multilaterals also allow the UK to scale up influence in places where there is not any (or significant) bilateral presence.

16. Against aid effectiveness criteria, multilateral aid can deliver some important advantages – i.e. less fragmentation and duplication, a more unified donor group to work with national governments on influencing and supporting national development policy, clearer and simpler accountability processes both for donors and recipients, etc.
17. In places where the UK has the appropriate infrastructure and relationships, bilateral aid can deliver many of the same advantages (i.e. a strong and productive relationship with recipient country governments and civil society can help to ensure and build country ownership, bilateral aid delivered through local civil society can help to build long-term, sustainable capacity and support government accountability, etc.).
18. Rather than determining a fixed balance between bilateral and multilateral channels, the assessment should be which funding channel to use, based on relative effectiveness and the impact/ results for people living in poverty.

F. Lessons from other national donors

19. Non-traditional providers/donors represent an increasing share of global aid-like flows (from approximately 8.1% in 2000 to 30.7% in 2009) and, as a recent ODI report[3] found, recipients welcome the increased choice, speed of disbursement and negotiating power this change gives them. The case study countries prioritised, in addition to the additional resources these new flows provided, ownership, alignment and speed which suggests some clear areas for improvement for traditional donors like the UK.

G. Monitoring and Influencing multilateral expenditure

20. DFID should strive for closer coordination with other bilateral donors and NGOs who have a presence in non-DFID countries to gather evidence on the performance of multilateral institutions.
21. Impact evaluation of aid through multilaterals is limited. DFID should prioritise funding to multilaterals with demonstrable effectiveness and value for money. The results chains and principles of transparency, accountability and traceability so rigorously applied to bilateral aid must also be considered and applied to all funds to multilaterals.
22. DFID should make every effort to prioritise funding to multilateral agencies who work effectively with civil society and beneficiaries.
23. DFIDs Multilateral Aid Review (MAR) is a bilateral review process. The Multilateral Organisation Performance Assessment Network (MOPAN) is a network of 17 donor countries, including the UK, who carry out joint assessments and shares information on the effectiveness of the multilateral organisations they fund. Different donor country objectives mean MOPAN assessments can’t provide what country reviews can, however there is room for closer coordination between the focus, findings and recommendations of DFIDs MAR Updates and the MOPAN Common Approach.
24. See Bond/UKAN submission to IDC Inquiry on the MAR.

[3] http://www.odi.org.uk/sites/odi.org.uk/files/odi-assets/publications-opinion-files/8188.pdf

June 2013

Further written evidence submitted by Bond and UKAN

3 July 2013

For more information on this submission, contact Joanna Rea, Policy and Government Relations Manager (jrea@bond.org.uk, 020 7520 0255) or Amy Dodd, UK Aid Network Coordinator (amy@ukan.org.uk, 020 3122 0637).

Introduction

1. Bond is the UK membership body for non-governmental organisations (NGOs) working in international development.
2. The UK Aid Network (UKAN) is a coalition of UK-based development NGOs working together to advocate for more and better quality aid through joint policy, lobbying and advocacy work.

Background

3. Recent indications from the Department for International Development and the Select Committee have suggested that the UK Government is more seriously considering increasing the proportion of UK aid provided as loans to the public or private sector, basically reintroducing bilateral ODA loans, and potentially creating a new facility to deliver that increase.
4. Currently the mandate of any new facility and the delivery mechanism for any such increase in ODA loans has not been determined but seems to encompass several possibilities from no change to a small, more virtual lending window to a fully independent investment bank.

UK aid

5. Under the 2002 International Development Act, **the central objective of UK development assistance is the reduction of poverty.** This can be either as bilateral aid, or via support to multilateral agencies. Aid can be targeted towards the public or private sector (or a mixture of the two), as long as it can be reasonably expected to contribute to sustainable poverty reduction.
6. **Overseas aid remains the only source of funding for development that is solely focused on tackling poverty.** The Prime Minister has spoken in December 2012 of the UK's "moral obligation" to help the world's poor, noting that there are still over a billion people living in extreme poverty.[1] Despite the real improvements in the lives of many of the world's poor, there remains much more to do and aid will be an important part of the solution.
7. This is the test against which any change in the Britain's aid spending must be measured and is explored in the following sections.

[1] *The Daily Telegraph* Dec 28, 2012. "Cameron: UK has a 'moral obligation' to help world's poor"

Arguments in favour of DFIs

8. DFIs are usually institutions set up by governments to **finance riskier, long-term term ventures, often in the private sector.** They provide a wide variety of functions, from direct credit provision, to equity purchases, provision of technical advice, leveraging investment from capital markets, and more. They also take on a variety of institutional formats and governance models; from state-owned bilateral development banks, to privately owned investment funds.
9. Donor governments in particular have historically advanced several arguments in favour of DFIs as development 'tools':
    i. 'Recycling' aid money potentially increases the impact of each £ of aid.
    ii. Provide a justification for the continuation of aid to MICs.
    iii. Stimulate private sector growth in the 'missing middle' of the business world in developing countries (medium sized enterprises that can't access international markets and are too large for microfinance).
    iv. Potentially reducing long-term aid dependency.
    v. Stimulate the development of local financial markets.
    vi. Potentially reducing the donor country's debt ratio as outgoing loans may be considered 'off-book'.
    vii. Loans could be funded by money borrowed on the international capital markets and subsidised down.

Arguments against DFIs

10. However there are also some **serious questions and concerns about the actual development impact of DFIs based on evidence from other DFIs which call into question the suitability of loans as an aid modality for the UK**. These concerns also raise questions about some of the arguments in favour of DFIs/loans discussed above.
11. Arguments about the benefit to donors must also be seen through the lens of development impact and results first and foremost.
12. **Evidence from other OECD DFIs suggests that the priorities and performance measurements are more often weighted towards financial return and evidence of contribution to financial growth than social development impacts**.
    i. Evidence from the aid effectiveness agenda suggests that aid is most effective when it is a genuine transfer that can be spent by a developing country to support national development strategies – 'recycling' aid, certainly in any substantial quantity, would undermine this and potentially reduce the impact of UK aid.
    ii. The question of aid to MICs is a live and complex one however aid of any form to MICs would necessarily still be targeting poverty and development and thus in large part targeting the poorest, most vulnerable and marginalised people. The appropriateness of increased loans and debt would need to be carefully considered in that context.
    iii. Economic growth is not a proxy for development as growth must be sustainable, pro-poor and inclusive to have genuine development impacts and there is currently insufficient evidence to support the argument that this is the case with

DFIs. Given this current lack of evidence, potential impacts on long-term aid dependency are also more questionable.

iv. Equally the area of the market that loans could most usefully seek to target, the missing middle, is potentially hard to reach and requires detailed and appropriate local knowledge suggesting that a donor-based loan facility may not be the most appropriate tool.

v. Lack of coordination and coherence with development agencies even within the same country. In some countries, such as Belgium, there is barely even any communication between the two different institutions.

vi. Bilateral development banks are the least preferred option for recipient countries (DFID was rated the best and bilateral banks the worst in a recent study of 32 HIPC countries[2]).

vii. Potentially undermining local ownership, a key principle of aid effectiveness, as the companies invested in are frequently based or owned outside the developing country.

viii. Lack of transparency particularly given the increasingly complex financial structures employed by DFIs including the use of financial intermediaries that use tax havens. These structures include which include direct equity purchases and debt financing, channelling money through pooled intermediary funds, use of financial intermediaries, private equity funds, and even financial derivatives. Given ongoing discussions about the need to harmonise global policies on tax avoidance, the UK government should be particularly concerned about the prevalence of using offshore tax havens by financial intermediaries.

ix. Duplication of costs and work – there are costs involved in running a bank which could increase the amount of the UK spends on administration particularly when there are already other DFIs which we fund through multilateral aid and our EU contribution – so the real additionality from a new UK bank is questionable.

x. Some DFIs have funded projects which have negative environmental, human rights , gender and social impacts despite exclusions blocking harmful activities.

xi. Loans evidently have an impact on a recipient country's debt sustainability - there are current concerns about growing debt burdens in many countries already and the 'development loans' sector is already overcrowded potentially over-heating local financial markets instead of stimulating them. In addition, there is currently not an effective means of resolving a debt crisis and the IMF and WB debt sustainability frameworks are focused on whether a debt can be paid not the impact on poverty/development and inequality and the UK has previously disregarded the Debt Sustainability framework.

Conclusion and recommendations

13. Overall **there is currently insufficient evidence to suggest that a new UK development bank or loan facility would provide true development additionality or that it would be an effective modality to deliver UK aid.** Evidence from other DFIs suggests that it could in fact be less effective than current modalities.

[2] Organisation Internationale de la Francophonie, April 2013.

14. There is currently **no evidence to suggest that the current range of development cooperation tools provided by the UK government, including DfID and the CDC[3], are insufficient to meet recipient country needs.**
15. **Any decision to change must be based on meeting the additionality and development impact test and we would recommend that DFID produce a clear and detailed business case to support any such change.**
16. If a new loan facility is created it must ensure that **UK aid remains focused on genuine development outcomes, poverty eradication and tackling in equality** and not assume that benefits will trickle down.
17. **Any new UK development bank or loan facility must follow best practice policy and procedure including:**
    i. Ensuring a **focus on qualitative development** objectives rather than simply quantitative financial and economic ones;
    ii. The **inclusion of civil society** in the design, monitoring and evaluation of project loans to ensure a pro-poor approach;
    iii. Supporting **host country ownership** to ensure the benefits of investments accrue locally;
    iv. Following standard **investment exclusion lists** and adhering to emerging international environmental, labour and human rights norms (e.g. the Rugge principles);
    v. **Avoiding financial intermediaries** who use tax havens;
    vi. Developing systems for **full public transparency** and accountability (i.e. over commercial confidentiality);
    vii. Undertaking careful **debt sustainability assessments** with independent civil society participation to avoid creating new public (or private) debt crises in developing countries;
    viii. Develop a **common rating tool** that could be used by all EDFI members, in order to facilitate comparability development impacts between DFIs.

[3] Please note that civil society has previously raised some questions and concerns about the CDC as part of the Future of CDC inquiry – written evidence from UKAN is available online here http://www.publications.parliament.uk/pa/cm201011/cmselect/cmintdev/605/605vw16.htm and from Bond here http://www.publications.parliament.uk/pa/cm201011/cmselect/cmintdev/605/605vw05.htm.

Written evidence submitted by Tearfund

This submission builds on Tearfund's earlier submission (specifically paragraphs 3.18 to 3.2) to this enquiry,

Climate finance for adaptation, and the private sector

1. **The onus is on the UK government to prove that private climate finance can deliver for adaptation. There is little evidence to date that this is the case. Nevertheless, private sector is increasingly championed as a solution that will plug the current gap in international climate finance.** The UK government is a key proponent of this view. It has taken a lead in using its own public climate finance to explore how private sector finance can be mobilised, investing £110 million from the UK's public climate finance (the International Climate Fund) in two commercial private equity funds which will leverage private co-investment as part of the UK's Climate Public Private Partnership (CP3) Platform.[1] It has also strongly supported the development of the Green Climate Fund's Private Sector Facility.

2. **Tearfund research[2] suggests that private finance lends itself more naturally to funding mitigation in developing countries, rather than adaptation**; furthermore, mechanisms for providing private sector finance for mitigation are better developed. The Overseas Development Institute recently compiled data around 73 climate finance investment initiatives totalling $8.5 billion by the UK, Japan, Germany and the US between 2010 and 2012 aimed at mobilising private climate finance. Of these investments more than 99 per cent went to mitigation projects and there was virtually no direct investment involving the private sector that targeted adaptation to climate change. Eighty-four per cent of investment flowed to middle income countries.[3]

3. **Evidence for private sector engagement with adaptation is minimal**, and what little there is indicates a number of problems in relying on private finance to deliver adaptation for the poorest communities.

4. **Analysis from private development financing suggests that Least Developed Countries (LDCs) and other low-income countries are unlikely to benefit from private investment**, and that financing is unlikely to flow to the most appropriate sectors for adaptation. Therefore, governments cannot rely on private finance to meet the adaptation needs of the poorest communities and countries.

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[1] Tearfund, *Private gain, public interest*, (2013), p.15.

[2] Ibid, http://tilz.tearfund.org/webdocs/Tilz/Research/Private%20gain%20Public%20interest%20-%20Tearfund.pdf

[3] Whitley, Shelagh (February 2013) *Five early lessons from donors' use of climate finance to mobilise the private sector*, ODI

Climate finance diplomacy

5. **The committee should interrogate the negotiating positions taken by the UK government at IMO and ICAO, as these hinder agreement on emissions levies which would raise climate finance namely:**

- Insisting that funds generated from emissions outside of national borders should be collected domestically and be part of national budgets**.** This is stopping discussions from progressing, without providing a workable alternative. Openness to considering innovative proposals from other stakeholders for levying a carbon charge on shipping and aviation globally would help break the deadlock.
- Not recognising that shipping and aviation should contribute to adaptation to climate change, in addition to reducing their emissions (or at least not opposing such contributions as part of a global deal).
- Not recognising that certain countries, including the LDCs, should be protected from disproportionate burden arising from carbon pricing of international transport (but not excluded as this would cause competitive distortions).

Scaling up climate finance

6. The UK has yet to show clearly how it plans to scale up its share of climate finance from the circa £1 billion per annum earmarked for fast-start finance, to the circa £6 billion per annum which would be its 'fair share' from 2020. The coalition agreement took forward the previous government's policy that no more than 10% of ODA should be used on climate finance. Because it is addressing an additional issues, all climate finance should be additional to aid: the government must begin to show where this will come from.

June 2013

Written evidence submitted by CDC

Introduction

1. CDC's experience lies only in making investments into the private sector in developing countries and the financial instruments DFIs use to contribute most effectively to the growth of the private sector. This submission will not, therefore, address areas of the Committee's Inquiry that fall outside these areas of expertise.

About CDC – who we are

2. CDC is the oldest development finance institution (DFI), established in 1948. Wholly-owned by government, it is part of the Department for International Development's (DFID) private sector strategy to alleviate poverty, but operates independently under the governance of an independent board. CDC aims to achieve positive impact where we invest, primarily by creating jobs, while also achieving a fair return on capital. It is a measure of CDC's success that it does not draw capital from the UK taxpayer, but invests from its own balance sheet and recycles profits into new investments.

About CDC – what we do

3. CDC supports the growth of businesses and job creation across all of Africa and South Asia – especially in the harder places. We aim to invest where our job creation focus can have greatest impact: in countries where the private sector is weak and jobs are scarce, and in sectors where growth leads to jobs – directly and indirectly – such as manufacturing, agribusiness, infrastructure, financial institutions, construction, health and education.

4. CDC invests to support the growth of all sizes of business from the micro-level right up to the largest because we believe that a balanced private sector is necessary for economic development and robust job creation. In doing so we like to demonstrate that it is possible to invest successfully in some of the harder places in the world. We aim to avoid providing capital where it is clear that fully commercial capital is plentiful.

About CDC – how we invest

5. CDC provides capital in many forms, including equity, debt, mezzanine and guarantees, and this capital is typically used for growth. We invest directly and through fund managers that we believe are aligned with our aims.

6. CDC invests capital to support the growth of private sector businesses and job creation across all of Africa and South Asia. We aim to invest where we can have greatest impact on job creation: in countries where the private sector is weak and jobs are scarce. Our focus is on sectors where growth leads to jobs – directly and indirectly – including manufacturing, agribusiness, infrastructure, financial institutions, health and education.

7. Unless businesses are economically and commercially sustainable, no impact can ultimately be achieved. To provide decent, long-term jobs a business must be financially sustainable and be run profitably, for the following reasons:

    - Profits enable companies to invest in training, R&D and expansion, as well as ensuring that they can withstand shocks such as the loss of a large customer.
    - A profitable company can survive without the on-going support of DFI capital and succeed in attracting other investors to finance its growth.
    - Making investments on commercial terms not only ensures that the jobs we help create are likely to endure over the long term, but it also demonstrates to other potential investors that reasonable returns can be made in difficult geographies.

8. Investing profitably also enables CDC to be self-financing. When CDC's investments and loans generate positive returns these are recycled back into future investments. This model means CDC has had no new capital from government since 1995 and doesn't cost the taxpayer a penny.

Concessional loans

9. There can be many benefits to concessional finance made to public sector projects on a multi-lateral or bilateral basis. In particular, concessional finance is used effectively by multilateral and bilateral

development banks, such as the World Bank or KfW, where the focus is on public-to-public co-operation. The loans are granted to organisations such as public utilities, municipalities, state-owned banks or directly to governments. Another existing model is where concessional loans are being provided to APEX institutions such as state-owned development banks or central banks, which then offer special lines of funding to private local commercial banks. However, in both cases, the loans are provided to public entities and normally come with an explicit government guarantee. Whenever private entities, such as commercial banks or private companies are involved, the provision of concessional funding has to be equitable and accessible to all qualifying entities in order to avoid market distortions.

10. A recent discussion between European DFIs regarding the potential benefits and impact of concessional finance (where the concession was achieved by blending loans and grants) noted the following benefits:

    - The ability to leverage development finance allowing donor countries to do more with less;
    - The potential for greater aid / development effectiveness and potential economies of scale generated as a result of better pooling of resources and co-ordination among development financiers;
    - The potential for enhancing the partner country governments' ownership of the development assistance due to the loan component; and
    - Potentially increased value added for developing countries, in terms of private sector development (notably banking and financial sectors) and demonstration effect.

11. At this discussion, the following questions and concerns were also raised as to their effectiveness, development impact and potential distortive effects. Specifically:

    - The risk of financial incentives outweighing development principles;
    - The risk to differentiate in favour of middle-income countries against poorer countries;
    - Risk of crowding-out private financing and distorting markets;
    - The risk of providing insufficient attention to transparency and accountability;
    - The risk of unclear or ill-defined monitoring and evaluation methods; and
    - The debt risks for developing countries of increasing lending.

12. For more information on these points please *see Krätke, F. 2013. From Purse to Policy and Practice. Six initiatives to future-proof EU development cooperation for 2014-2020 and beyond (ECDPM Briefing Note 51, publication date June 6 2013).*

Provision of concessional finance by new UK development bank

13. CDC has no view on whether an independent development bank would be needed to provide concessional finance, as opposed to DFID offering such products directly. However, it is important that clear differentiation is maintained between private sector promotion, which largely should not be done via concessional finance, and public financial co-operation.

June 2013

Written evidence submitted by the Department for International Development

INTRODUCTION

1. The Department knows from its recent horizon scanning and analysis – and analysis produced by others, including the IDC – that the development landscape has changed rapidly, and will continue to change rapidly, affecting the nature, context and geography of poverty and the future prospects of the poor. In recent years, many developing countries have experienced fast growth, and in most parts of the world, poverty has been decreasing, albeit at vastly different rates across countries and regions. DFID also knows that population trends, urbanisation, natural resource riches and technology will offer a unique opportunity to accelerate and lock in these gains. Despite this opportunity, the majority of the poor will live in transition countries (with average incomes of less than £1,000 per person per annum), with an ever increasing number concentrated in fragile states, and in countries affected by the impact of climate change and resource scarcity.

2. The analysis also highlights that the financing support to, and the needs of, developing countries is changing, due to economic growth and the rise of alternative funding sources, including capital markets and emerging powers. Private sector investors as well as large scale private philanthropy have become increasingly important; so too have remittances. The World Bank estimates remittance flows to developing countries rose by 6.5% in 2012 to total US$406 billion and are projected to grow to US$685 billion by 2015.

3. These changing financing flows and the changing prospects for poverty exit by the poor in some countries, determined by the extent and pattern of economic growth, challenge how development is supported. This is especially true in the poorest countries (low-income countries), the most fragile countries (where conflict and violence is the biggest barrier to reducing poverty) and those countries which are transitioning out of extreme poverty.

4. The combination of the changing context of poverty, alternative financing sources and the rising UK development budget have led the Secretary of State to initiate internal work on the kind of organisation DFID wants and needs to be to support the new post-MDG framework and tackle the development challenges in 2015 and beyond.

Question 1: Whether the 0.7% ODA target will be appropriate in the long term

5. The UN's development financing target, which calls on economically advanced countries to allocate 0.7% of their GNI to Official Development Assistance (ODA), is both long-standing (having been first enshrined in a UN resolution in 1970) and widely recognised. In 2005, for example, EU Heads of States specifically committed to increase collective EU ODA to 0.7% of GNI by 2015. Since 2002, the combination of the Millennium Development Goals and the 0.7 target have resulted in renewed political support for official

development finance and an unprecedented increase in global ODA levels. The 0.7 target also provides a firm benchmark against which to measure donor effort and encourage international burden sharing. The Government is therefore committed to spending 0.7% of GNI as ODA from 2013 onwards.

6. The Government believes that the 0.7% target will continue to have relevance in the longer term, both as an established benchmark for international burden sharing, and as a way of encouraging an on-going flow of ODA. With its tightly governed definition, concessional nature and focus on poverty reduction, ODA will continue to play a critical role in global development. It is important to complement this quantitative target with measures of quality and impact of development cooperation.

Question 2: Whether DFID has the right mix of financial instruments and whether it should introduce new ones, including concessional loans, the balance between loans and traditional grant aid; and the role of the UK as a provider of climate finance.

Question 3: Specifically whether the UK should establish a new, independent development finance institution to offer concessional loans

7. As countries steadily transition and become emerging economies the Department's increased emphasis on economic development means there are a number of possible new financial instruments which could be introduced alongside traditional grant financing and the operations of CDC. For example, lending to partner governments and enhancing private sector capital flows into developing countries.

8. Lending could occur either on DFID's balance sheet or through a separate legal entity, which could be a small-sized entity or a larger independent development finance institution. All of these options could lend to multilaterals such as the World Bank who then on-lend or to countries either by co-financing multilateral loans or as stand-alone lending.

9. The criteria being used to assess these options, including whether the UK should set up a separate legal entity for lending, are:

i) Development effectiveness: In terms of addressing barriers to poverty reduction and allowing a new partnership with these countries.

ii) Administrative requirements: The time needed to introduce an instrument, the skills required and cost of administration.

iii) Potential demand: This would need to be determined by a variety of factors including: if a country has a development financing gap, its debt levels as informed by the IMF's Debt Sustainability Analysis, the nature of UK engagement, and if DFID has a comparative advantage.

iv) ODA and IDA frameworks: The UK's development expenditure must adhere to the Official Development Assistance (ODA) guidelines and the UK's International Development Act.

v) The implications for Government expenditure and borrowing: the extent to which an instrument might enable a higher level of ODA for a given level of government expenditure and the impact on the Government's net public sector borrowing requirement.

10. For an independent development finance institution the administrative requirements and the implications for government expenditure and borrowing are particularly relevant. Officials are currently exploring the administrative costs of similar institutions as well as discussing with HM Treasury the impact on the PSBR.

11. For climate change related finance, DFID is increasingly financing intermediaries to provide loans, guarantees (an example being the Asia Solar Loan guarantee) and equity (e.g. CP3 Climate £110 million equity project) alongside grants and reimbursable grants (challenge funds). It has also invested in micro-insurance schemes e.g. for smallholder farmers and is looking at wider insurance schemes e.g. Africa Risk Capacity. These instruments give us more flexibility to address specific market failures e.g. equity is particularly useful for high risk businesses such as early stage ones. The Green Africa Power project uses debt with equity features to address the absence of long-term patient capital for power plant projects in Africa and a contingent credit feature to tackle power plant construction risk concerns. Along with bidding mechanisms such as advance market commitments or reverse auctions these instruments can reduce the risk of over-subsidy, which is important not just for taxpayer value for money but also to avoid distorting the market and crowding out competition or local finance players. Guarantees can address investors' concerns around policy risk or perceived risks effectively or underwrite for example carbon market type instruments.

12. The OECD DAC definitions and rules set some constraints on the use of loans, equity and guarantees in a bilateral project. This is something a number of countries, including the UK, are raising in ODA reform discussions at the Development Assistance Committee and in the EU.

Question 4: Whether DFID has the right balance between bilateral and multilateral aid

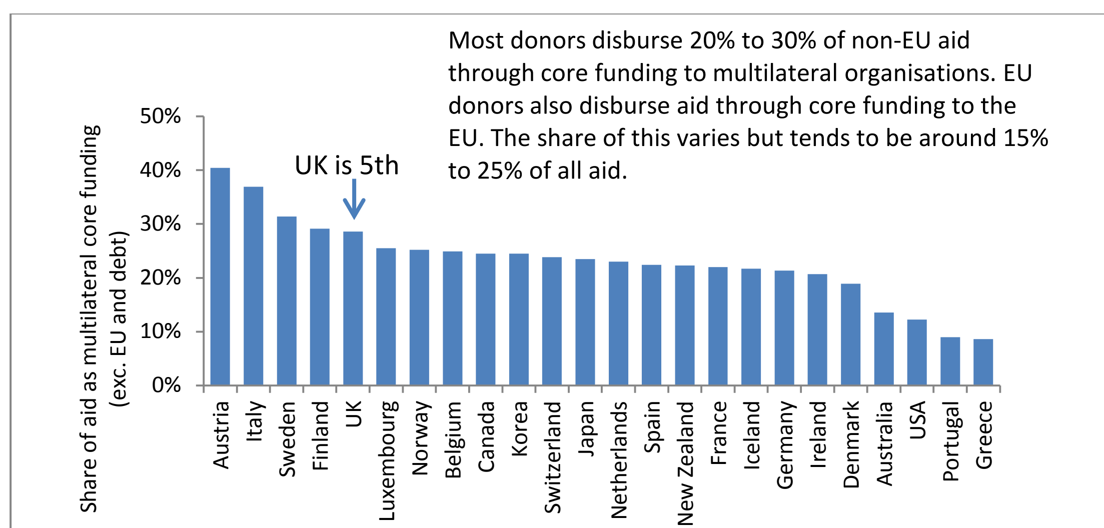
13. Decisions on bilateral funding were based on the Bilateral Aid Review (BAR), which identified good value for money results offers from DFID country offices, (building bilateral allocations from the bottom up). Similarly, the decisions on core multilateral aid from 2011 up until now were based on the Multilateral Aid Review 2011 (MAR), which assessed value for money for UK aid across the multilateral organisations. Based on these assessments, Ministers increased funding to the best organisations, and stopped funding to the worst - except where wider UK interests or critical development roles

implied a need for continuing UK engagement to urge reform. The MAR was commended by the NAO in its recent review, noting that “The Department’s multilateral aid review provided a much improved basis for deciding how to allocate funding and for promoting multilateral effectiveness.”

14. In making decisions about our multilateral funding, wherever multilateral organisations are delivering outputs that could be delivered through DFID’s own bilateral programme we want to consider which channel would deliver the best value for money. It is important to note that there is not often direct competition between multilateral organisations and the DFID bilateral programme. Instead, multilateral organisations often perform roles which complement those of bilateral programmes – delivering public goods such as international agreements, reaching the poorest in conflict zones where bilateral donors are not welcome, shaping markets to reduce the cost of vaccines for poor countries, managing large, complex regional infrastructure projects, for example – and this makes it difficult to make direct comparisons of value for money across the two channels.

15. Comparing DFID with other bilateral donors, the data suggests that DFID gives a slightly higher share of non-EU aid through core multilateral funding than most donors, but that it is well within the normal range of 20% to 30%. .

Table 1. Multilateral funding as a share of all aid for DAC donors 2011



Source: 2012 DAC Report on Multilateral Aid, OECD 2013

<u>Question 5: What lessons can be learnt from other national donors</u>

16. Some donors use their bilateral development agencies to directly provide a greater range of development finance instruments, from grants in low income countries, to loans at close to market rates in middle income countries. Loans to middle income countries often combine public budget funds with funds raised at capital markets. This allows those donors to provide financing that is specifically targeted to the country situation and the sector.

Other bilateral agencies also use innovative ways of leveraging private sector resources. Germany, for example, uses their development bank, KFW, for loans, including structured models with first loss schemes.

17. In the US, USAID does not carry out sovereign lending but works directly in development finance through the Development Credit Authority (DCA). Guarantees do not score as ODA but they facilitate financial flows to developing countries. Since its establishment in 1999, DCA has facilitated $2bn of credit for 100,000 borrowers in 67 countries.

18. The Swedish Development Agency, SIDA, also has an innovative guarantee scheme for small and medium-sized enterprises, which underwrites working capital loans for trade. SIDA does this in addition to its ODA spending.

19. Using bilateral agencies to directly provide a wider range of financing instruments can also have disadvantages, for example higher transaction costs for recipients of aid due the need for them to negotiate multiple agreements, deal with multiple donor missions and report in a variety of formats.

20. As part of its economic development focus, DFID is expanding its use of loans, guarantees, insurance schemes and equity alongside grants and reimbursable grants (challenge funds), we are working closely with other donors to learn from their experience.

Question 6: How DFID should monitor and influence expenditure by multilateral institutions, including in regions and countries where DFID does not have bilateral programmes

21. DFID gathers information on multilateral performance from a wide variety of sources, including: evaluations, assessments by the Multilateral Organisation Performance Assessment Network (MOPAN) and other bilateral donors, feedback from DFID country offices, feedback commissioned for the MAR from NGOs, visits to non-DFID-focus countries, and evidence from multilateral organisations themselves, either obtained through our membership of governing bodies, or specially requested.

22. The range and quality of these sources varies across the multilaterals. Full organisational evaluations based on country case studies tend to take place only every 3-5 years, if at all. MOPAN assessments, which usually gather evidence from 8-10 countries, are also on a 3-5 year cycle. Some organisations publish annual Development Effectiveness Reviews which synthesise information from across all of their operations, but many do not. DFID country office feedback, visits to non-DFID-focus countries, and feedback from NGOs are therefore important supplements to these other sources.

23. Core multilateral funding decisions are subject to the same programme management processes as other funding decisions in DFID. This includes

annual assessments of progress against reform and results priorities, documented and published in Annual Reviews. Multilaterals are also being assessed this year through the MAR update process. This draws on information from all of the sources listed above, and compares and contrasts to draw out consistent messages. In some areas, the evidence base has been strong; in others, it has been weaker, and this will be set out clearly in the refreshed MAR assessments. DFID believes that the updates are a valuable assessment of the extent to which multilateral organisations have improved their performance since the MAR was carried out and published in 2011.

24. Individual bilateral projects and programmes delivered through multilateral agencies are also subjected to the same detailed scrutiny and the same business case process as all other bilateral aid. DFID spending departments are required to assess the strategic and tactical fit of the proposed programme, explore alternative options for delivering the same results, and analyse costs and benefits.

25. Gathering good quality evidence about in-country performance from across a wide range of countries remains challenging. DFID has focused on reforming MOPAN, so that it collects information on a wider range of organisations more frequently, and on accessing country office feedback from other bilateral donors with different country presence.

26. Influencing multilateral organisation performance takes place at different levels. The MAR has proved extremely successful as an influencing tool with MAR leadership. This impact has been amplified, as it has spurred others on to do similar exercises, often drawing on the UK's MAR methodology (e.g. Australia, Canada) and/or data (e.g. Denmark). The multilaterals have been very constructively engaged with the MAR update – a clear indicator of how much it matters to them.

27. The UK is influential in the governing bodies of most multilateral organisations, partly because we are a relatively large funder and partly because our expertise in respected. However, the NAO noted in their report on DFID's MAR published on 19 September 2012 that "they expected the Department to… tighten its approach to promoting and monitoring reform within individual agencies." Going forward, the Department plans to do more learning around influencing multilateral reform, drawing on best practice on evaluating influence.

28. At country level, DFID offices who are using multilaterals as delivery partners engage with them to improve their performance and feed information back to the centre as necessary. The relationship between the DFID UK office and country offices has been strengthened considerably over the last two years, with the recruitment of three country engagement managers. This is enabling DFID to take a much more consistent and consolidated approach to monitoring the value for money and effectiveness across the board from using multilaterals to deliver bilateral aid, and a much stronger and more systematic approach to promoting reform.

June 2013

Further written evidence from the Department for International Development (DFID)

The International Development Act 2002 permits DFID to provide both grants and loans. The then Overseas Development Administration provided loans in the 1970s and 1980s but ended these facilities in the light of the debt crises of the 1990s switching to provision of grants only to sovereign governments. However given the changing context within which we work, including that the majority of the world's poor now live in middle-income countries and resolution of the debt problems of most low-income countries, we are exploring whether we still have all the right instruments available.

July 2013

Written evidence submitted by the Bretton Woods Project

Summary

1. The Bretton Woods Project is an independent non-governmental organisation (NGO) established by a network of UK-based NGOs in 1995 to take forward their work of monitoring and advocating for change at the World Bank and IMF. See www.brettonwoodsproject.org/about for more details.

2. We welcome the decision of the International Development Committee (IDC) to undertake this inquiry. Our comments focus on the World Bank. At present, the World Bank is the largest multilateral recipient of UK aid, with the UK having become the largest International Development Association (IDA, the Bank's low-income arm) donor at the last replenishment, and the Bank also being the recipient of a significant amount of additional UK funding.

3. **The role of the UK as a provider of climate finance:** The UK is channelling large volumes of its climate finance through the World Bank Group despite the lack of country ownership and failure to identify and reach those most in need. The projects have also been of variable quality and have been accused of furthering development bank agendas rather than piloting new innovative approaches. The UK should redirect climate finance to support the Green Climate Fund and other UN initiatives, such as the Adaptation Fund, while limiting the World Bank's role in climate finance, including in the Green Climate Fund.

4. **The right balance between bilateral and multilateral aid:** The World Bank's poor track record, excessive focus on large-scale infrastructure, and insufficient attention to the impacts of its projects on climate change and land tenure are evidence that it is not the most effective means for channelling aid spending. The increasing concentration on lending to the private sector has unproven development outcomes and the investment in the financial sector is both risky and further obscures results. DFID should not increase contributions to the World Bank Group with its increased aid budget absent substantial reforms in key areas.

5. **Monitoring and influencing the World Bank Group.** The UK needs to consider the needs and concerns of developing country governments and people affected by World Bank activities. It can work towards strengthening accountability mechanisms and independent evaluation as well as enhancing transparency of its own interaction with the Bank and addressing the legitimacy problem that comes with the Bank's insufficiently reformed governance structure.

A: Effectiveness of the channelling climate finance through the World Bank Group

6. The UK has committed £2.9 billion to international climate finance until 2015 through the International Climate Fund, including £1.5 billion in fast start finance from 2010-12. As of May 2013 the UK had provided over $1 billion to the World Bank-housed Climate Investment Funds (CIFs), including £813 million in fast start finance, making the UK its biggest donor. The UK is also supporting other Bank initiatives, including £130 million (£51 million in fast start finance) to the Climate Public Private Partnership (CP3), £10 million in

fast start finance to the Bank-housed Forest Carbon Partnership Facility (FCPF) and £7 million in fast start finance to the Bank-led Partnership for Market Readiness (PMR).[1]

7. The CIFs have been criticised from their inception, including concerns about their governance structures (including the role of the World Bank) and lack of legitimacy because of their distance from the official UN Framework Convention on Climate Change (UNFCCC) process. Furthermore, the Bank's role as both trustee and implementer is deemed controversial.[2] These critiques have been strengthened as the new UNFCCC Green Climate Fund is being operationalised, meaning the CIFs are supposed to 'sunset'. However, few concrete actions have so far been taken to activate this sunset clause.[3] The UK has so far declined to pledge financial support for the Green Climate Fund, despite the critical importance of donor funding to ensure its viability. In its engagement with the Green Climate Fund, the UK has primarily focused on the development of the private sector facility, despite limited evidence of the ability of the private sector to play a strong role in climate change adaptation. An increased push for the private sector is also seen in the CIFs, including an increased role for the International Finance Corporation (IFC, the Bank's private sector arm).

8. Other criticism of the CIFs includes lack of country ownership and failure to identify and reach those most in need. The projects have also been deemed of variable quality and have been accused of furthering multilateral development bank (MDB) agendas rather than piloting new innovative approaches. The CIF Clean Technology Fund (CTF) has received severe criticism from CSOs for supporting large scale projects, designed for electricity export rather than for energy access for local populations. There is evidence that the Pilot Program for Climate Resilience (PPCR, one of the CIFs) has been MDB driven, with weak structures for participation of local communities. The Forest Investment Program (FIP, another of the CIFs) has been rejected by local communities and indigenous peoples in many countries, including because of its impacts on intact forests and links to commercial logging. The Scaling Up Renewable Energy Program in Low Income Countries (SREP, another CIF) is less advanced, but has already been criticised for not prioritising poor countries. Furthermore, the results frameworks for the respective CIFs as well as gender aspects require further work.[4]

9. The UK published its annual internal evaluation of the CIFs in July 2012. The evaluation noted some problems, such as "there remains limited information on the expected results" on FIP. Other challenges noted include "slow speed of disbursement and project approval" and "variable quality of some investment plans and projects". It also noted that "lack of clarity over future of CIFs and implications for the potential funding gap should the GCF not be up and running quickly" remains. Key government recommendations included to keep pushing for the results framework to be finalised "to enable this improved monitoring of results" and to "push for a risk management framework". Furthermore, it noted that "while

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[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/200437/UK_Fast_Start_Climate_Finance_Final_doc2.pdf

[2] See A faulty model? What the Green Climate Fund can learn from the Climate Investment Funds http://www.brettonwoodsproject.org/art-568686

[3] See various editions of the CIFs Monitor http://www.brettonwoodsproject.org/cifs/index.shtml and A faulty model? What the Green Climate Fund can learn from the Climate Investment Funds

[4] See various editions of the CIFs Monitor http://www.brettonwoodsproject.org/cifs/index.shtml

good progress has been made on the measures to improve the CIFs, we should continue to watch implementation, for example on gender and development, and transparency."[5]

10. The CP3 is implemented in collaboration with the Asian Development Bank and an IFC private equity fund. While only in inception stage it has already attracted criticism for its focus on middle-income countries, lack of transparency and accountability, and lack of focus on energy access.[6]

11. The World Bank push for carbon market initiatives, including the PMR and FCPF, has also been criticised, in particular given flagging carbon markets and due to the possible negative impact on indigenous peoples.[7]

12. Key recommendations:

- *DFID should ensure climate finance is governed by sustainable and equitable principles including: a participatory approach; in support of renewable technology; pro-poor focus; through a democratic institution; under UN supremacy; and using grants, not loans.*

- *DFID should redirect climate finance to support the Green Climate Fund and other UN initiatives, such as the Adaptation Fund, while limiting the World Bank's role in climate finance, including in the Green Climate Fund.*

B. Balancing bilateral and multilateral aid - Effectiveness of the World Bank Group

13. In many critical areas the World Bank's performance has been poor. An annual Independent Evaluation Group (IEG) report on the *Results and performance of the World Bank Group 2012*, released in December 2012, showed declining effectiveness, with the Bank's worst ratings in areas with the fastest increases in lending or extra priority, such as infrastructure and public-private partnerships (PPPs). The report from the IEG, the Bank's arms-length evaluation body, covered projects closed before end June 2012 and looked across the entire World Bank Group. Good ratings on investment loans fell from 78 per cent for 2006-08 to 70 per cent in 2009-11. "Among the projects that exited the active portfolio in FY09-11, 26 per cent were rated either satisfactory or highly satisfactory, and 44 per cent were rated moderately satisfactory", showing that even the positive ratings are driven predominantly by mediocre results.[8]

14. According to the IEG report, particularly problematic were investment loans for infrastructure and to projects in the East Asia and Pacific region, both of which saw statistically significant drops in good ratings for 2009-11. In its analysis of why things were going badly in infrastructure, agriculture, and beyond, the IEG found "overambitious project design, inadequate consultation with stakeholders, insufficient

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[5] See Climate Investment Funds Monitor 6, 26 October 2012 http://www.brettonwoodsproject.org/art-571458
[6] See "False Solutions? The IFC, private equity and climate finance" Bretton Woods Project, *Bretton Woods Update* No. 80, 5 April 2012 http://www.brettonwoodsproject.org/art-569966
[7] See "Carbon capture: World Bank's climate actions to 'breathe new life' into carbon markets " Bretton Woods Project, *Bretton Woods Update* No.85, 8 April 2013 http://www.brettonwoodsproject.org/art-572251
[8] For a longer summary of the report please see "IEG finds declining impact at Bank, IFC", Bretton Woods Project, *Bretton Woods Update* No. 84, 13 February 2013, http://www.brettonwoodsproject.org/art-572003

candour during supervision, and failure to follow up on problems identified during supervision missions as reasons for less-than-satisfactory achievements." However, infrastructure, and particularly large cross-border projects is an area where the Bank is planning an expansion of its work[9] despite past practice showing that this is an area rife with corruption possibilities, overspending and under-delivering on results. While no one doubts that there is an under investment in infrastructure in most developing countries, the renewed focus on mega projects rather than pro-poor infrastructure, such as rural roads or low-carbon off-grid energy, is a worrying trend.

15. The World Bank Group maintains an ineffective set of staff incentives which do not effectively prioritise value for money, development effectiveness or sustainability. While Bank staff are expected to consider development effectiveness, gender, and a suite of safeguards, their internal incentives prioritise meeting volume targets on their lending.[10] Volume targets are not a good indicator of value for money or development effectiveness and in fact may encourage poor value as staff rush to meet targets at the end of the year with lower standards applied to projects.

16. The World Bank has a poor track record when it comes to the management of environmental and social impacts of its projects. Though the World Bank introduced environmental criteria into its operations in 1987 and began disclosing environmental impact assessments in the early 1990s, a plethora of projects still proceed without adequate attention to environmental or social concerns. Additionally, the World Bank still invests heavily in fossil fuel projects, creating negative impacts in relation to climate change. In essence it is subsidising carbon-intensive energy projects at the same time that the G20 has been endeavouring to eliminate fossil fuel subsidies. According to a November 2012 working paper by US-based NGO World Resources Institute, the Bank "has actually increased lending for fossil fuel projects and coal plants in recent years". The paper estimates that the Bank is currently funding 29 coal plants worth $5.3 billion, making it the second largest public international financer of coal-fired power plants, after the Japan Bank for International Cooperation.[11]

17. Accountability for failing to uphold World Bank standards is also lacking. In fiscal year 2012, five projects had inspection requests filed with the Inspection Panel, the Bank's compliance arm, with a further three cases filed in FY 2013. In one of these cases, relating to the Vishnugad Pipalkoti dam project in Northern India, Bank staff in India publicly repudiated any accountability by pre-empting Inspection Panel findings with public statements that the project would go ahead regardless of any findings of the Panel.[12] This highlights a problem with the Panel's mandate, unlike a true judicial

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[9] The drive for expansion of infrastructure finance is partly emanating from the G20, see more details at: "Big infrastructure, small participation: World Bank and G20 push new plans", Bretton Woods Project, *Bretton Woods Update* No. 77, 13 September 2011, http://www.brettonwoodsproject.org/art-568883

[10] For a detailed description of staff incentives see "Inside the institutions: World Bank staff incentives", Bretton Woods Project, *Bretton Woods Update* No. 85, 8 April 2013, http://www.brettonwoodsproject.org/art-572265. Further detail of how World Bank staff respond to incentives can be found in: *The Matrix System at Work: An Evaluation of the World Bank's Organizational Effectiveness*, Independent Evaluation Group, World Bank, April 2012, http://ieg.worldbankgroup.org/content/dam/ieg/matrix/matrix_eval.pdf.

[11] For more details on this case please see "Getting its hands dirty: World Bank increases fossil fuel lending", Bretton Woods Project, *Bretton Woods Update* No. 84, 12 February 2013,

[12] For more details on this case please see "Getting its hands dirty: World Bank increases fossil fuel lending", Bretton Woods Project, *Bretton Woods Update* No. 84, 12 February 2013, http://www.brettonwoodsproject.org/art-571959.

accountability mechanism, it is not able to force Bank management to make amends for harm caused by projects.

18. The Bank has recently faced vociferous criticism for its impact on land tenure and land rights, particularly of poor or marginalised communities. The Bank has been accused of aiding and abetting land grabs in many countries, including through a forest project in Uganda[13], a palm oil project in Uganda[14], rubber plantations in Cambodia/Lao[15], a commercial real estate project in Cambodia[16], and through foreign farm land acquisitions across Africa[17] and Latin America[18]. The Bank's work on the principles for Responsible Agricultural Investment has been consistently rejected by groups representing small farmers.[19] While in April this year the World Bank president has accepted the need to work instead with the UN-organised Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security, no action has yet been taken on this front.

19. The World Bank finally launched an expected review of its environmental and social safeguard policies in October 2012. Whilst the Bank committed to a robust outcome, civil society organisations have highlighted concerns that the emerging framework will replace existing safeguards with vague principles and non-mandatory 'flexible' implementation standards.[20] Furthermore, the review only covers investment lending, but not other instruments, such as development policy lending and Program-for-Results. Bank management itself has not highlighted the implementation failures related to existing safeguards or the gaps in coverage[21], but instead the time it takes for projects to navigate the project cycle, leading to worries about dilution of the already inadequate system. For example, the Bank safeguards do not include a requirement for "free, prior

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[13] See more about the Oxfam published study of the case in this article: "Call for freeze on World Bank 'land grabs'", Bretton Woods Project, *Bretton Woods Update* No. 83, 6 December 2012, http://www.brettonwoodsproject.org/art-571586.
[14] See more about the Friends of the Earth published study of the case in this article: "New claims of rights abuses in World Bank-funded 'land grabs", Bretton Woods Project, *Bretton Woods Update* No. 81, 3 July 2012, http://www.brettonwoodsproject.org/art-570786.
[15] A May report from NGO Global Witness, *Rubber Barons*, details allegations of land grabbing by IFC-funded Vietnamese rubber companies operating illegally in Cambodia and Lao. See http://www.globalwitness.org/rubberbarons.
[16] See "Accountability squandered? World Bank should wait for justice in Cambodia", Bretton Woods Project, *Bretton Woods Update* No. 81, 22 June 2012, http://www.brettonwoodsproject.org/art-570766.
[17] More detail on a study of African land grabs by the Oakland Institute is available in this article: "World Bank policies "enabling" African land grab", Bretton Woods Project, *Bretton Woods Update* No. 77, 14 September 2011, http://www.brettonwoodsproject.org/art-568890.
[18] More detail on a study of Latin American land grabs by the Oakland Institute is available in this article: : "Call for freeze on World Bank 'land grabs'", Bretton Woods Project, *Bretton Woods Update* No. 83, 6 December 2012, http://www.brettonwoodsproject.org/art-571586.
[19] See joint statement "It's Time to Outlaw Land Grabbing, Not to Make It 'Responsible'!", published by Focus on the Global South, http://focusweb.org/content/its-time-outlaw-land-grabbing-not-make-it-responsible.
[20] See "Safe in Bank hands? World Bank safeguards review launched", Bretton Woods Project, Bretton Woods Update No. 83, 6 December 2012, http://www.brettonwoodsproject.org/art-571573.
[21] For a deeper examination of the gaps in coverage please see "Initial Comments by Civil Society Organizations on the World Bank Safeguards Review", December 2012, http://www.bicusa.org/wp-content/uploads/2013/01/Initial+Comments+by+Civil+Society+Organizations+on+the+World+Bank+Safeguards+Review.DEC2012.pdf.

and informed consent" of indigenous peoples as spelled out in the UN Declaration on the Rights of Indigenous People, which the UK has endorsed.[22]

20. In a number of significant ways, the Bank's approach does not support country-led development. The Bank has somewhat reduced the use of policy conditionality, but a 2012 internal World Bank review[23] of one of their policy lending instruments (development policy loans or DPLs) developing countries reported that the use of prior actions has "remained at 10 per operation". The concerns over the use of 'one size fits all' conditionalities remain, restricting the pursuit of democratically chosen policies appropriate to national contexts. In the review, the Bank themselves rated only 17% of prior actions as having positive social and environmental effects.

21. The Country Policy and Institutional Assessments that largely determine allocations to IDA countries have also been heavily criticised by developing country governments, the IEG and civil society for not effectively reflecting country ownership, need and effectiveness.[24] While the Bank has increasingly recognised that the aid allocation formulas are problematic, they have moved to amend them in this year's IDA replenishment only for countries that are considered fragile or conflict-affected.

22. The World Bank is increasingly relying on group-wide strategies and the involvement of the private sector to deliver development results. However there is little evidence of the ability of the private sector to deliver development results. A systematic review of private participation in infrastructure, which looked specifically at a DFID and IFC supported facility[25], found that "hard evidence is scarce" and that "it is difficult to measure causal relationships between infrastructure provision and development outcomes." It found that it was "very difficult for [development finance institutions] to achieve enhanced direct poverty effects using purely commercial finance", which is the claimed modus operandi of the IFC, and the number of projects that this could be achieved on was strictly limited.

23. On top of this the IFC is increasingly using financial intermediaries, meaning third-party financial entities such as banks, insurance companies, leasing companies, microfinance institutions, and private equity funds. In early February the IFC's accountability mechanism, the Compliance Advisor/Ombudsman (CAO), released an audit report that found that for this growing part of the IFC's portfolio, now over 40 per cent of the total, the IFC conducts "no assessment of whether the [environmental and social] requirements are successful in doing no harm." The CAO indicated that "The result of this lack of systematic measurement tools is that IFC knows very little about potential environmental or social impacts of its [financial market] lending." The same lack of knowledge also applies to the development impacts of the financial sector lending. Despite pressure from civil society and the CAO, the IFC has refused to recognise that

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[22] For a further discussion of gaps in coverage and recommended enhancements to the safeguards, please see "Safeguards: World Bank urged to incorporate human rights commitments "in all of its activities", Bretton Woods Project, *Bretton Woods Update* No. 85, 8 April 2013, http://www.brettonwoodsproject.org/art-572246.
[23] http://go.worldbank.org/3M7EPD0GB0
[24] See this article for more detail: "IEG calls for overhaul of World Bank's lending criteria", Bretton Woods Project, *Bretton Woods Update* No. 69, 15 February 2010, http://www.brettonwoodsproject.org/art-565918.
[25] Spratt, S. and Ryan-Collins, L.(2012) 'Development Finance Institutions and Infrastructure: A Systematic Review of Evidence for Development Additionality', http://www.ids.ac.uk/publication/development-finance-institutions-and-infrastructure-a-systematic-review-of-evidence-for-development-additionality.

there is a problem with their systems for measuring results or risks from sub-clients of the IFC's financial sector clients.[26]

24. World Bank President Jim Yong Kim took over at the World Bank in mid 2012 and wants to reshape the Bank according to his own strategic vision. This strategic change and restructure will set the future direction for the Bank, but is as of yet incomplete. It would be premature for the UK to commit to increasing funding for the Bank and its concessional grants arm, given the uncertainty over the strategic directions of the Bank. They may improve the effectiveness of the Bank, or they may take it in the wrong direction.

25. Evidence so far on the new strategy has not been encouraging. Dr. Kim set two overarching goals for the Bank without effective external consultation with stakeholders. These goals have been set despite there being a robust global debate, in which the UK Prime Minister is closely involved, in what should come after the Millennium Development Goals. Dr. Kim's speeches have reiterated emphasis on growth and very large-scale infrastructure without sufficient attention to inequality, participation of affected people,

26. Key recommendations:

- *DFID should not increase contributions to the World Bank Group with its increased aid budget absent substantial reforms in key areas, including climate and energy, the aid allocation formula, and the modality of providing finance to the private sector, and in radically improving the legitimacy, transparency and accountability of the institution.*

- *Any bilateral investment institutions should carefully consider their potential value addition above existing institutions and the problems identified with the IFC's operating model.*

C. Monitoring and influencing the World Bank Group

27. The World Bank Group should take remedial measures in a number of areas, which can be facilitated by shareholder monitoring and influencing. Unfortunately the multilateral aid review focussed predominantly on bilateral UK priorities with little developing country input and ownership. Care should be taken that the UK does not dictate agendas to the Bank that are not in line with either developing country government wishes or the concerns of poor people affected by the World Bank's activities.

28. At the World Bank there is insufficient use of independent assessment and no requirement for action in response to critical evaluations.[27] This is true for both the IEG and the accountability mechanisms such as the Inspection Panel and the CAO. One of the most effective mechanisms for improvement at the Bank would be to strengthen the

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[26] For more detail on this issue please see: "IFC oblivious to impact of lending to financial sector", Bretton Woods Project, *Bretton Woods Update* No. 84, 12 February 2013, http://www.brettonwoodsproject.org/art-572062.

[27] *Review of IFC's policy and performance standards on social and environmental sustainability and policy on disclosure of information*, Compliance Advisor /Ombudsman, 2010; "World Bank performance standards review reveals need to raise the bar", Bretton Woods Project, *Bretton Woods Update* No. 71 , 18 June 2010, http://www.brettonwoodsproject.org/art-566404.

independent evaluation and accountability mechanisms with greater independence and requirements for Bank action in response to findings of shortcomings in Bank policy and practice.

29. Ensuring that civil society organisations can effectively participate in decisions making processes at the Bank and engage with both policy and projects would also enhance effectiveness of the institution. This would especially be the case in countries where DFID does not have programmes. The Bank's Global Program for Social Accountability (GPSA), launched this year, is supposed to help enable this, but design flaws lead to worries of the programme being compromised from the beginning with potential for the funds being used to silence opposition or whistleblowers.[28]

30. The Bretton Woods Project believes that transparency is a key element of accountability. The UK used to be a world leader in terms of transparency of its activities in relation to international financial institutions, with annual reports to parliament on the activities at and priorities for both the World Bank and IMF. Unfortunately these reports have increasing arrived late and have scaled down their coverage. This can be improved.

31. The democratic deficits at the various arms of the World Bank Group reduce the institution's legitimacy. The latest round of governance reforms left high-income countries with over 60 per cent of voting power across the World Bank Group – Bank claims to the contrary were based on a faulty classification of countries. Those countries in which the Bank's impacts are felt, and who provide funding through loan repayments, have only a minority share. Low-income countries hold 6 per cent of voting shares averaged across the different arms of the World Bank, including just 11 per cent at IDA.[29] G24 developing country ministers have stressed that redressing the "democratic deficit in the governance structure is crucial for the legitimacy and effectiveness of the World Bank."[30] The UK should pursue deeper governance reform at the World Bank.

32. **<u>Key recommendations</u>**:

- *DFID should seek to enhance the strength and enforceability of the Bank's evaluation and accountability mechanisms.*

- *DFID should push for the achievement of at least parity in voting rights between developed and developing countries to be achieved by 2015.*

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[28] For some outlines of the problem see: "Social accountability compromised?", Bretton Woods Project, *Bretton Woods Update* No. 85, 9 April 2013, http://www.brettonwoodsproject.org/art-572280.
[29] These figures are calculated using the Bank's income-based classifications of countries. They therefore differ from the Bank's figures, which refer to categories that do not properly reflect countries' economic status. See: "Analysis of World Bank voting reforms", Bretton Woods Project, 30 April 2010, http://www.brettonwoodsproject.org/art-566281.
[30] See "G24 Ministers call for deeper governance reforms and more tailored lending instruments for developing countries", Third World Network, 30 April 2010, http://www.twnside.org.sg/title2/finance/2010/finance100402.htm.

Written evidence submitted by VSO

VSO is an international development agency with 55 years of experience working in poor countries around the world. We take a unique approach to tackling global poverty, by placing committed volunteers with carefully selected partners - from grassroots orgnanisations to government ministries. Our volunteers use their skills to improve the impact of aid efforts for poor and marginalised people. By working closely over time with partner organisations, they provide the right support to help ensure that local development efforts deliver the greatest impact and lasting change.

VSO welcomes the opportunity to submit evidence to this inquiry on the future of Development Cooperation. Our short submission will focus on two aspects of the inquiry: the appropriateness of the 0.7% ODA target in the long term, and whether DFID has the right balance between bilateral and multilateral aid.

Whether the O.7% ODA target will be appropriate in the long term:

1. Around the world, VSO volunteers have seen the impact of UK aid and our partner organisations have benefited from the UK's historic commitment to development. We welcomed the commitment in the Coalition Agreement in 2010 to enshrine in law our commitment to spend 0.7% of national income on international development assistance[1]. This followed commitments made by all parties prior to the 2010 General Election to reach this target and meet the ambitions set by the global community in the 1970s.

2. VSO welcomes the Government's continued commitment to development and applauds the UK Government for meeting its target to spend 0.7% of GDP on International Development Assistance, as announced in the March 2013 budget.[2] With dwindling resources for aid internationally and with many Governments stepping away from their previous commitments, we believe it is more important than ever that the UK continues to play a leadership role. We are disappointed, therefore, that the Government's plans for the next Parliamentary session did not include plans to enshrine the 0.7% commitment into law. Legislation would send a powerful message to donor Governments, including those who pledged support for development at Gleneagles in 2005, and would help to encourage other developed countries who have not yet met the 0.7% target to do so.

3. Whilst seven European countries have already met or exceeded ODA targets, Europe as a whole missed its collective target in 2010, leaving a development financing gap of 18 billion Euros[3]. It is critical that governments in Europe and beyond realise and build on the 0.7% commitment before starting new debates about alternative financing mechanisms.

4. The UK has a long and proud history of providing overseas development aid. The work of the Department for International Development alone is estimated to have lifted around 3 million people out of poverty in recent years[4]. UK aid has saved lives around the world meaning that four million fewer children are dying now than in 1990[5]. This work is well documented, but UK aid has

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[1] "The Coalition: Our Programme for Government"; HM Government 2010
[2] VSO Press release, 20 March 2013, available at: http://www.vso.org.uk/press-releases/uk-budget-confirms-the-uks-position-as-a-world-leader-in-fighting-global-poverty-says
[3] Ibid.
[4] "Small Change, Big Difference"; ONE/Development Initiatives, 2012
[5] Save the Children, 2012

also strengthened communities around the world by making them more resilient and capable of taking control of their own development.

5. Aid has also allowed countries to develop to a point where they require less assistance. Countries such as Vietnam and Thailand have seen the proportion of aid they receive decrease as economic growth and private sector development has taken hold. In India, the development assistance the country receives as a percentage of GDP is 10 times less than it was in 1968[6]. Among the 'next eleven' emerging economies identified by Goldman Sachs, several are currently in receipt of UK Aid or have been in the past including Bangladesh, Nigeria, Pakistan and Vietnam[7].

6. In countries such as Malawi, VSO volunteers have seen the impact that donors, national government and NGOs working together can have on the lives and livelihoods of poor people. The Sector Wide Approach (SWAp) that was adopted in the Malawian health sector brought together DFID, the Malawian Government and NGOs such as VSO to strengthen the country's health system.

7. A 2010 evaluation of the SWAp found that the coverage of health services across the country had been extended and health outcomes had improved at "a more rapid rate than comparable countries"[8]. The presence of a number of international donors had "leveraged more support" from Government and donors and improved outcomes for poor people. This approach is only possible, however, due to the support of DFID who provide around a third of the Malawian health service's budget. This has meant that the impact of support offered by NGOs has been multiplied by both greater co-ordination and targeting of aid through the SWAp and the ability to attract even greater support.

8. In an increasingly interconnected world, the fortunes of people in the UK are linked to the fortunes of people in developing countries. It is therefore in our national interest to support international development efforts. The untapped potential of developing nations represents lost customers, lost trade and, ultimately, lost economic growth for the UK and the global economy.

9. Investing in effective development means investing in new markets for UK companies abroad. The UK is a world leader in a number of important sectors such as construction and electrical, optical and high tech goods, all of which are expected to grow significantly in developing and emerging economies between now and 2020. As UK aid is used to lift more people out of poverty and to provide developing countries with opportunities to enter international markets, UK companies will have an expanded market as new companies develop and consumers have increased disposable income. The Confederation of British Industry (CBI) has estimated that the impact of the UK working in new markets in these sectors could lead to a £20bn boost to the UK economy[9].

10. Effective aid, particularly when targeted at fragile and conflict affected states, can assist in averting security threats and instability. For example, with 43% of the world's population now under the age of 25[10] concentrated in some of the world's poorest nations, well targeted aid can provide better life chances and opportunities to young people who would otherwise face a future with little or no prospects.

11. Research by the Overseas Development Institute found that poor information on aid flows means that governments in developing countries frequently have to make decisions on the basis of

[6] Living Proof, Bill and Melinda Gates Foundation, 2009
[7] "It is time to redefine emerging markets", Goldman Sachs, January 2011
[8] "Impact Evaluation of the Sector Wide Approach (SWAp), DFID, June 2010
[9] "Winning Overseas: boosting business export performance", CBI, 2011
[10] "State of the World Population"; UNFPA, 2011

"partial, inaccurate and unreliable information."[11] Legislation committing governments to a particular level of spending on overseas development assistance is particularly important, therefore, for the long term health and sustainability of the economies of developing countries.

12. Binding commitments to aid spending also goes some way to averting the dramatic consequences which can result from unforeseen cuts in aid budgets. As a result of the economic crisis, many donor countries are reversing previous aid spending commitments, with $3.4bn cut from aid budgets between 2010 and 2011. The OECD expects aid to stagnate after this year as the full effects of the global downturn are felt. This comes at a time when the World Bank has warned that developing countries are running out of policy options to avert the worst impacts of the economic crisis hitting the poorest people[12].

13. As the High Level Panel on the Post 2015 Development Agenda reported in May 2013, official development assistance (ODA) that flows to developing countries is still a very important source of financing: 55 cents of every dollar of foreign capital that comes into low-income countries is ODA. [13]

Whether DFID has the right balance between bilateral and multilateral aid;

14. VSO welcomes the Government's reviews of both bilateral and multilateral aid in 2010, and efforts to re-focus its development efforts on the poorest countries around the world. We understand that DFID needs to focus its resources and to change its funding allocation as countries develop. We agree with the Government's approach to invest more resources in least developed countries (LDCs) and fragile states. In general, these countries require most effort to reach the MDGs. VSO has recognised this in our latest strategy and is working to increase our work in LDCs and fragile states. For example, in July 2011 VSO opened a new programme in South Sudan focussing on Health, Education and Good Governance.

15. VSO has also changed its approach in middle income countries such as China: VSO is the first NGO to be assisting Chinese people to develop their own volunteering programmes which will work to address poverty within their own countries and other countries in the region. China has a wealth of professional skills that can be shared with communities within its own country and in others parts of Asia, in the Pacific and Africa.

16. As stated in our submission to DFID's bilateral aid review in 2010[14], VSO believes that DFID should continue to invest in strong public services in the countries in which they work. High levels of investment in recruitment, training and retention of health workers and teachers are essential to provide quality healthcare and education in developing countries.

17. Both bilateral and multilateral aid should be harmonised with local and national strategies to avoid duplication and ensure country ownership. VSO is a member of Bond, and supports their calls to improve the quality and impact of development cooperation, in line with the Paris Principles and subsequent Busan Partnership for Effective Development Cooperation. Effective cooperation between donors is essential if poor countries are able to plan their own aid programmes. The Busan agreement goes much further than previous aid effectiveness

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[11] "Greater Aid Transparency: crucial for aid effectiveness"; Overseas Development Institute; January 2010

[12] "World Bank Projects Global Slowdown, with Developing Countries Impacted", World Bank Press Release, January 18th 2012, retrieved from http://goo.gl/V91wf.

[13] "A New Global Partnership: Eradicate poverty and transform economies through sustainable development" The Report of the High Level Panel of Eminent Persons on the Post 2015 Agenda

[14] VSO Submission to DFID's Bilateral Aid Review, October 2010

commitments in recognising this, placing more emphasis on democratic ownership of development and accountability to aid beneficiaries.

June 2013

Written evidence submitted by the International HIV/AIDS Alliance (herein 'the Alliance')

This submission focuses on why the 0.7% Overseas Development Assistance (ODA) target will be appropriate in the long term, especially in the response to HIV. It also highlights the critical role that civil society plays in international development, particularly in fighting the HIV pandemic, and calls on DFID to increase its support to civil society organisations via Programme Partnership Agreements (PPA's). The submission also stresses the importance of continuing aid to Middle Income Countries (MICs), where the majority of poor and marginalised people live.

The International HIV/AIDS Alliance (herein 'the Alliance'), established in 1993, is a global partnership of nationally-based linking organisations, working in over 40 countries to support community action on AIDS. We welcome this opportunity to provide a submission to the International Development Committee (IDC) inquiry on the Future of UK development cooperation. Our submission responds with a focus where appropriate on issues relating to the UK's global HIV response.

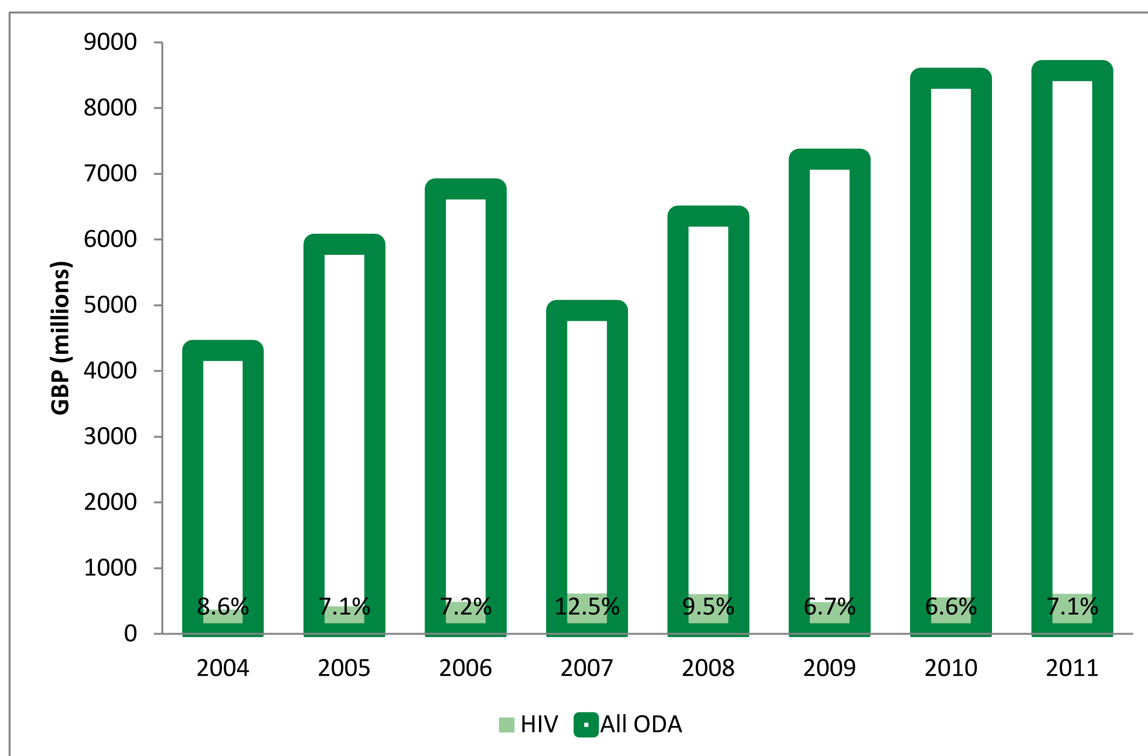
Key recommendations:

1. The UK government should enshrine its commitment to maintaining ODA at a level of at least 0.7% of GNI, with ODA calculated in line with OECD DCD-DAC definitions to exclude money spent on defence or peace keeping.
2. The UK government should champion the inclusion of the 0.7% target in the post 2015 development framework
3. DFID should bring the percentage of funding for civil society organisations that is spent on HIV into line with the overall proportion of ODA which is allocated to the HIV response.
4. DFID should develop mechanisms to ensure the sustainability of funding for civil society organisations and networks based in middle income countries if bilateral programmes have ended, and should actively consider the re-introducing of regional PPAs.
5. DFID should work with the FCO to combine support for networks and organisations of populations facing human rights violations, including those at higher risk of HIV, in a joint funding instrument combining access to justice, protection of human rights defenders, stigma and discrimination reduction, advocacy and research.
6. The UK should announce a new commitment for the September 2013 Global Fund to Fight AIDS, TB and Malaria (Global Fund) replenishment meeting of £1 billion over 3 years.

Question 1: Whether the 0.7% ODA target will be appropriate in the long term

1. The UK's longstanding commitment to achieve the 0.7% aid pledge has determined its position as an international development and global health champion, especially in relation to the HIV response at the heart of the G8 and G20. At Gleneagles for example, the UK persuaded other G8 countries to commit to universal access to HIV treatment, a pledge which means that today more than 8 million people in poor countries are receiving lifesaving medicines. Since then, the UK has consistently been the second largest donor to HIV (behind the US) and an important supporter of the Global Fund, which was judged by the 2011 Multi

Lateral Aid review as providing very good value for money[1]. As evidenced by the graph below, while the total amount of money the UK has delivered for HIV has increased over the last 8 years, the amount of these funds as a percentage of ODA has stabilised at between 6.6% and 7.1% from 2009 to 2011. This demonstrates how the gradual realisation of the



0.7% ODA target has enabled the UK to maintain a strong contribution to the HIV response.

2. The UK has played a key role in challenging other countries to honour their promises on aid for developing countries, especially on pledges to achieve the Millennium Development Goals (MDGs). The UK has also been a leader in delivering effective aid that achieves results for poor people and provides value for money, both for British taxpayers and for recipients.

3. The 0.7% target was first committed to by the UK in 1974, and subsequent governments from both the Conservative and Labour parties have reaffirmed their commitment to achieving it. During the 2010 UK General Election campaign, all three main parties committed to reach 0.7% by 2013 and to enshrine this commitment in law.

4. Since the Coalition came to power in May 2010, the Prime Minister David Cameron, Chancellor of the Exchequer George Osborne and the International Development Secretary Justine Greening have reaffirmed the government's willingness to meet the UK's long-standing commitment to reach 0.7% of UK ODA as a share of GNI in 2013. Last September, the Prime Minister stated that it would be wrong to use the economic downturn as an excuse to go back on aid pledges[2], while George Osborne and Justine Greening have both underlined that achieving the 0.7% aid target is the UK's "commitment to the world's poorest[3]" and "is the right thing to do and the smart thing to do[4]".

[1] *Multilateral Aid Review: Assessment of the Global Fund to Fight AIDS, TB and Malaria,* February 2011. Last accessed 2 June 2013 from: https://www.gov.uk/government/publications/multilateral-aid-review-assessment-of-the-global-fund-to-fight-aids-tb-and-malaria-gfatm.

[2] *David Cameron reaffirms UK aid pledge at United Nations*, BBC News, 26 September 2012. Last accessed 3 June 2013 from: http://www.bbc.co.uk/news/uk-politics-19709321

[3] https://www.gov.uk/government/speeches/autumn-statement-2012-chancellors-statement

5. The Alliance supported these statements and welcomes the Government's recent announcement that it will reach 0.7% this year. In doing so, the UK will become the first member of the G8 to meet the long-standing UN target. By reaching the 0.7% target, the UK stands as an example that providing support to the world's poorest people should be a moral imperative beyond national, political and economic debates.

6. We also strongly support the inclusion of a target on achieving 0.7% under Goal 12 in *The Report of the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda*[5]. David Cameron was co-chair of the High Level Panel while over 500,000 people have inputted into the Post-2015 process through national, regional and thematic submissions globally. According to analysis from the UN Millennium Project led by the economist Jeffrey Sachs, 0.7% of GNI from industrialised countries could provide enough resources to meet the MDGs[6]. **As we move towards a new post 2015 development framework, the inclusion of a target within the High-Level Panel's report is a strong mandate and a call to action for other developed countries to meet 0.7%. With the post 2015 framework likely to lead up to a deadline of 2030, it also outlines why 0.7% is an appropriate for the longer term.**

Protecting the 0.7% target in law

7. In a March 2012 report on the economic impact and effectiveness of development aid, the House of Lords Economics Affairs Committee stated that enshrining the 0.7% figure in law "would deprive future governments of the flexibility to respond to changing circumstances at home and abroad". Lord MacGregor, Chairman of the Committee, said that development aid should be judged by the criteria of effectiveness and value for money, not by whether a "specific arbitrary spending target is reached"[7]

8. The Alliance believes that changing economic circumstances or indeed political whim cannot justify cutting assistance to the world's poorest people. If aid were cut to the Global Fund to Fight AIDS, TB and Malaria for example, this would see a decline in the availability of lifesaving HIV and TB medicines, resulting in a surge in preventable deaths as well as in drug resistance and new infections. Similarly on Malaria, if funding for insecticide-treated bed nets and other Malaria prevention interventions suddenly dropped, a generation of children who have never developed resistance to the illness would be at risk. As some scientists have put it, the gains of the last ten years could be undone in one rainy season.

9. The Alliance is also concerned by suggestions that the UK could use aid money for defence or peace keeping. This would mean a reduction in aid as it is defined by the OECD Development Co-operation Directorate (DCD-DAC). Critically, it would also mean less money for interventions which are core to development, such as health, education and livelihoods.

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[4] UK to become first G8 nation to meet 0.7% aid pledge, Thomas Reuters Foundation, 20 March 2013. Last accessed 3 June 2013 from: http://www.trust.org/item/?map=uk-to-become-first-g8-nation-to-meet-07-pct-aid-pledge/

[5] *A new global partnership: Eradicate poverty and transform Economies through sustainable Development,* The Report of the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda, May 2013. Last accessed 3 June 2013 from: http://www.post2015hlp.org/featured/high-level-panel-releases-recommendations-for-worlds-next-development-agenda/

[6] *The 0.7% target: An in-depth look*, UN Millennium Project. Last accessed 3 June 2013 from: http://www.unmillenniumproject.org/press/07.htm

[7] *Abolish 0.7% UK aid target, say peers*, The Guardian, 29 March 2012. Last accessed 3 June 2013 from: http://www.guardian.co.uk/global-development/2012/mar/29/abolish-uk-aid-target-say-peers?INTCMP=SRCH

10. Enshrining the 0.7% ODA target in law would protect the aid budget from political whims and ensure greater accountability to Parliament and the UK public on what it is allocated to and how it is spent. Legislation could also help in shifting the debate away from quantity and towards a focus on the vital issue of aid quality and outcomes. Despite negativity in some parts of the media, we know that when the UK public is well informed about aid, people here support the 0.7% aid target. A short and inspirational film by the campaigning organisation ONE revealed that many people in the UK believed aid volumes to be much higher than they really are, with some thinking that up to 70 per cent of the national budget was diverted overseas[8]. The film also showed that when people realised how much was being achieved with just 0.7% of GNI, they were very supportive of aid, while in a Guardian online poll, 64% of respondents agreed that we need 0.7% to be enshrined in law. **The Alliance joins a wide range of overseas aid and development agencies in calling on the government to deliver on its manifesto pledge and enshrine its commitment to maintaining ODA at a level of at least 0.7% of GNI, with ODA calculated in line with OECD DCD-DAC definitions to exclude money spent on defence or peace keeping.**

Question 2: Whether DFID has the right mix of financial instruments and whether it should introduce new ones, including concessional loans; the balance between loans and traditional grant aid; and the role of the UK as a provider of climate finance

11. The UK government has been able to dramatically extend its reach into communities and to the most vulnerable and marginalised through its support to civil society, a key funding channel. In 2011-12 the UK disbursed £369 million through UK civil society organisations (CSOs), up from £329 million in 2010. Of this total, DFID reports that £162m funded Programme Partnership Agreements (PPA's); £14m went to the Civil Society Challenge Fund; £13m to the Governance Transparency Fund; £36m for humanitarian assistance; and £144m was distributed through other DFID bilateral programmes.

12. In 2010/11, 2.1% of this funding for civil society organisations was apportioned to fighting HIV[9]. This is a very low level of funding compared to the 6 to 12% of UK ODA that is allocated to tackling HIV. It is also low considering the high burden of mortality for which HIV is responsible – it is still the leading cause of death among women of reproductive age in Africa. In light of the DFID-funded extensive and authoritative study conducted by the World Bank '*Investing in Communities Achieves Results*'[10], it is now widely accepted that civil society organisations play a critical role in the HIV response. **We recommend that DFID increase this percentage to bring it at least into line with the overall proportion of ODA which is allocated to the HIV response.**

13. DFID's 2011 HIV position paper states that DFID mainly funds HIV through PPAs or direct funding for networks of key populations most affected, such as the International Network of People Who Use Drugs and the Global Forum of Men who have Sex with Men. These networks play a critical role in delivering HIV prevention, fighting stigma and ensuring that

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[8] *What do people really think about international aid?* March 2013. Last accessed 2 June 2013 from: http://www.one.org/international/blog/video-what-do-people-really-think-about-international-aid/

[9] From meeting with DFID Civil Society Partnerships Team, 2012. This figure has been questioned by the DFID AIDS and Reproductive Health Team but, if incorrect, DFID should announce the correct figure.

[10] *Investing in Communities Achieves Results,* Rosalía Rodriguez-García, René Bonnel, David Wilson, and N'Della N'Jie, The World Bank, 2013. Last accessed 3 June 2013 from**:** http://aidsconsortium.org.uk/wp-content/uploads/2013/01/9780821397411.pdf

policies aimed at addressing HIV reach those most at risk. These networks often operate in contexts of criminalisation and hostility from national governments, and it is imperative that international funding be sustained. DFID is bringing bilateral programmes in middle income countries (MICs) to an end, despite the fact that the majority of those most at risk of HIV live in MICs. **There is great concern about the sustainability of funding for networks and organisations based in these countries and mechanisms are needed to ensure that they are able to access funding after bilateral programmes have ended.**

14. Through PPAs, DFID currently funds a number of UK organisations that deliver HIV programmes or research. **DFID PPA support to the Alliance for example has played an important part in enabling us to reach 4.7 million people across 39 countries last year[11].** In recent years DFID has also funded very effective regional PPAs across a number of organisations (see case study below) and funding for these should be sustained.

15. In their latest report on PPAs, the Independent Commission for Aid Impact stated that more benefit could be drawn from PPAs if DFID were to "refocus on the added value they can provide as a strategic instrument, in particular when contrasted with the other CSO funding mechanisms". DFID failed to define what it hoped to gain from working in partnership with CSOs and, as a result, has gained less than it might have done. In particular, the CSOs' knowledge, influence and expertise could be adding further value to DFID's work."[12]

16. The recent DFID PPA reviews provide an opportunity for DFID to increase funding for CSOs that can prove they are delivering value for money and impact. DFID's ongoing review of its HIV work includes an assessment of the way that DFID extends its reach through civil society, and based on this analysis it should expand civil society funding mechanism to deliver impact for the most vulnerable and marginalised. **As discussed above, increased funding for civil society partners should be an important part of DFID's new approach to MICs.**

17. Improving co-ordination between DFID and the FCO is also essential to better support to networks and organisations of populations facing human rights violations, including those at higher risk of HIV. **DFID and the FCO should combine support in a joint funding instrument[13] that would entail a strategic combination of interventions such as access to justice, protection of human rights defenders, stigma and discrimination reduction, advocacy and research.**

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[11] Data from the year 2012

[12] *DFID's Support for Civil Society Organisations through Programme Partnership Arrangements (PPAs),* Independent Commission for Aid Impact, 17 May 2013, p.1. Last accessed 3 June 2013 from: http://icai.independent.gov.uk/2013/05/17/independent-commission-for-aid-impact-publishes-reports-on-dfids-use-of-contractors-and-programme-partnership-arrangements/

[13] *Making it work: Lessons learnt from three regional workshops to integrate human rights into national HIV strategic plans* International HIV/AIDS Alliance and UNAIDS, October 2012**.** Last accessed 3 June 2013 from: www.aidsalliance.org/publicationsdetails.aspx?id=90616

Case study: Latin America

In Latin America HIV is concentrated among key populations (transgender women, men who have sex with men and sex workers) but government commitment to a targeted HIV response for these groups is minimal and this aspect of the response is heavily dependent on international aid. Key populations are a matter of grave human rights concern due to social stigma, violence, human rights violations and the impunity with which these are committed.

DFID's Latin American Partnership Programme Arrangement (LAPPA) has empowered organisations of populations at higher risk of HIV to reduce HIV-related stigma and discrimination, to have a greater voice in decision making processes and to hold their national governments to account. Through the LAPPA PPA, the Alliance has worked with the Latin America and Caribbean Network of Transgender people (Redlactrans) and the Latin American Network of Sex Workers (Redtrasex). Both organisations enjoyed exponential growth under the LAPPA programme. In 2004, Redtrasex had six national member organisations, compared to 15 in 2012, representing over 15,500 individuals across the region.

Redtrasex has had unprecedented success in shaping national policies and local regulations so that they better protect sex workers' human rights and access to HIV services. For example, Redtrasex members have secured the repeal of local regulations that prohibited sex workers' free circulation in Panama City and three states in Argentina; replaced the stigmatising *Sex Workers Health Card* in Ecuador with a Comprehensive Healthcare Card which has increased access to health services.

Redlactrans' presence increased from three countries in 2008 to 17 in 2012. Redlactrans' advocacy focuses on changing the law to recognise the legal identity of transgender people, and was instrumental in passing historic Gender Identity Laws in Argentina, Uruguay and Mexico City. National AIDS programmes in Argentina, Nicaragua, Bolivia, Peru, Uruguay and Mexico now include 'friendlier' services for transgender people, including access to HIV treatment and prevention with specific attention to their needs.

The increased participation of both networks in decision making processes has also helped to increase funding for HIV services targeted at sex workers and transgender people. A regional Redtrasex project has received $ 12m from the Global Fund to increase sex workers' access to HIV and health services over the next 5 years.

Despite these successes, the LAPPA programme was discontinued in 2010 on the basis that most countries in the region are classed as middle income. The empowerment of transgender and sex workers communities in Latin America is at a crossroads regardless of the perceived economic wealth of the region. The HIV response in Latin America can only be successful when governments and donors strategically target their funds to addressing the specific needs of populations at higher risk for HIV. **Regional PPA's have been a very effective way of delivering critical support and DFID should actively consider re-introducing them in Latin America and other regions.**

Question 4: Whether DFID has the right balance between bilateral and multilateral aid

18. About two-thirds of UK HIV funding to date has been delivered through bilateral HIV programmes, but between now and 2015, DFID is planning a shift in favour of multilaterals such as the Global Fund. A recent analysis by the Guardian of DFID's bilateral country spending plans found that the share of HIV funding as a percentage of health bilateral aid will drop from 16% in 2010-11 to less than 6% in 2014-15[14]. This is partly a move towards greater donor co-ordination and cost-effectiveness, but also the result of major reductions in DFID HIV staff who could manage bilateral programmes.

19. The UK has been channelling an increasing share of total HIV funding through multilaterals that it assessed as 'very good value for money' during its last multilateral aid review in 2011, particularly the Global Fund. The UK had made substantial contributions each year since the start of the Global Fund in 2002 and in 2007 it supported long-term predictability by making a seven year pledge totalling £1 billion. The UK is to be highly commended for consistently delivering on its pledges and, in response to recent funding crises at the Global Fund, for bringing forward contributions to cover gaps. DFID publicly assures that following the results of its ongoing mini multilateral aid review, it will make an increased commitment and the Alliance and others are calling for a new commitment for the September 2013 Global Fund replenishment meeting of £1 billion over 3 years.

20. At the same time, we are concerned that the major planned decrease in HIV bilateral funding may seriously hinder DFID's ability to fund areas of particular niche / comparative advantage or ensure that funds get through to groups who may struggle to gain funding from government, multilaterals or other donor sources. For example, there is serious concern among HIV advocates in the Latin American region that they may be excluded from applying for future Global Fund grants. Should the Global Fund's remit become more focussed on low income countries, there will be major HIV funding gaps in middle income countries. On top of this, the UK is itself shifting bilateral funding to focus on low income countries and fragile states and is in the process of pulling out or pulled out of many middle income countries where it makes critical contributions to the HIV response through its bilateral programmes (Vietnam, India, the Caribbean and South Africa). The question then remains what range of UK funding and technical support mechanisms, if any, will the UK ensure are available to meet under-supported HIV interventions in these countries. **Critical technical and financial support is still needed and DFID needs to more meaningfully map out the options available for providing this.**

June 2013

[14] *UK aid money: the key datasets you need to know,* The Guardian, 26 September 2012. Last accessed 3 June 2013 from: http://www.guardian.co.uk/global-development/datablog/2012/sep/26/uk-aid-money-key-datasets

Written evidence submitted by Consortium of British Humanitarian Agencies

About the Consortium of British Humanitarian Agencies (CBHA)
The CBHA consists of eighteen NGOs[1] that form an innovative node in the global civil society network. The consortium was formed in 2010 with an initial two-year pilot grant from the UK Department for International Development (DFID).

Executive Summary

0.1 Humanitarian response and prevention has been segmented from overall development cooperation by the international community[2]. The future development agenda should recognise challenges of a humanitarian nature. Improper humanitarian risk management continues to contribute to lost developmental gains.[3]

0.2 The impact of disasters will become more frequent and intense in decades ahead, and current levels of global capacity cannot match this increased level of need. A number of universal trends, such as demographic change, climate change, urbanisation and economic turbulence will add to the humanitarian caseload and the complexity involved. The existing system is biased towards large scale infrequent events, even though suffering in smaller, frequent crises is enormous.

0.3 The humanitarian system is constantly evolving, but crisis-affected people and local actors still have little influence over the decisions that are made. Civil society's role in humanitarian response, preparedness and prevention is not maximised; NGOs & CBOs implement the majority of humanitarian work on the ground, but have little influence over how, when and where this funding is spent as well as whom is best placed to respond.

0.4 The NGO 'business model' has eroded NGO proactive capacity, because in most cases NGOs leverage privately raised resources into larger scale government donor contracts. This has a strong effect on the humanitarian system, as timely humanitarian action is vital for effective and cost-efficient results. The problems can be summarised as follows:

1. The direct funding for humanitarian action, preparedness and prevention by NGOs is insufficient, especially funding made available to local and national civil society actors
2. Humanitarian funding is not timely due to indirect flows via multilateral administered pooled funds and front-loaded controls; it takes weeks (or months) before international, national and local NGOs have access to response funding
3. The funding that eventually reaches civil society partners is unaffordable and unsustainable due to the unrealistic provision for cost recovery rate (overheads) offered on grants by donors such as DFID.

0.5 These issues require leadership from the UN, other multilaterals as well as bilateral donors such as DFID. The CBHA has developed an initiative to address this business model challenge, namely the Start Fund, which aims to contribute to a more proactive, sustainable, and locally-led model for the contiguum[4] of humanitarian action.

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[2] Oxfam argues in its recent 2013 publication No Accident: Resilience and Inequality of Risk that "development aid has often been blind to the shocks and uncertainties that poor people face, and naïve in assuming that development takes place in largely stable environments" (p. 4).

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[4] In current resilience discourse 'contiguum' refers to a situation where there is not necessarily a smooth linear progression from disaster to sustainable development, as invariably there can be a number of felt shocks and stresses that require intervention, making the process more circular.

Introduction

1.1 There is a false divide between humanitarian and development aid. Long-term development objectives try to address root causes of poverty and vulnerability, but repeated exposure to extreme events further weaken community resilience. The Organisation for Economic Co-operation and Development (OECD) has recognised that failing development efforts in fragile contexts can leave humanitarianism overstretched.[5]

1.2 A few core principles play a central part in humanitarian action that are based on over 100 years of practice and enshrined in international legal instruments. The core principles are: humanity (human kind shall be treated humanely in all circumstances); humanitarian imperative (the right to receive and give humanitarian assistance); impartiality (provision of assistance must not discriminate but be based on need alone); and independence (humanitarian agencies must formulate and implement their own policies independently of third party motives).[6] Essentially, the principles aim to ensure on the one hand that affected communities can understand and trust humanitarian actors and on the other that humanitarian actors can establish and maintain access to affected people.

1.3 Most international NGOs originated with a humanitarian imperative which widened over the years to more of a 'development narrative' in order to address the root causes of human suffering. Over time, despite frequent and recurrent humanitarian crises, the development sector has outgrown the humanitarian one, which is partly visible in financial terms. In 2009-2010 DFID spent only 6.3% (GBP 428 million) of its overall budget on humanitarian assistance.[7] Another indicator is that the ratio of staff in agencies working on humanitarian versus long term development is biased towards the latter. Worldwide, spending to support resilience, preparedness, or disaster risk reduction is minimal.[8]

2. External challenges of a changing world

2.1 Natural and manmade disasters are affecting more people, more often, and at more cost than ever before. According to the UN International Strategy for Disaster Reduction (UNISDR), disasters killed 1.3 million people and affected 4.4 billion people between 1982 and 2012. They also caused US$2 trillion of damage, more than the total development aid given over the same period.[9] The world currently counts "over 70 million people who are forced migrants – which is more than one in every 100 citizens – displaced by factors like conflict, political upheaval, violence and disasters."[10] Disasters and conflicts have negative macro-economic effects, and significantly affect world trade flows.[11] Furthermore, there are indirect and long-term negative effects of crises, such as the impact on people's mental health and children's cognitive and developmental capacities.[12]

2.2 Humanitarians are, in Lord Ashdown's words, losing the race between the growing size of the humanitarian challenge and our ability to cope. The frequency of both small- and large-scale emergencies is growing, according to the 2012 UK Government Foresight report. The report predicts that global environmental change and demographic shifts will contribute most to increased hazard exposure and vulnerability.[13] By the end of the 21st century, 1-in-20 year events are expected to become 1-in-15 or even 1-in-5-year events in many regions.[14]

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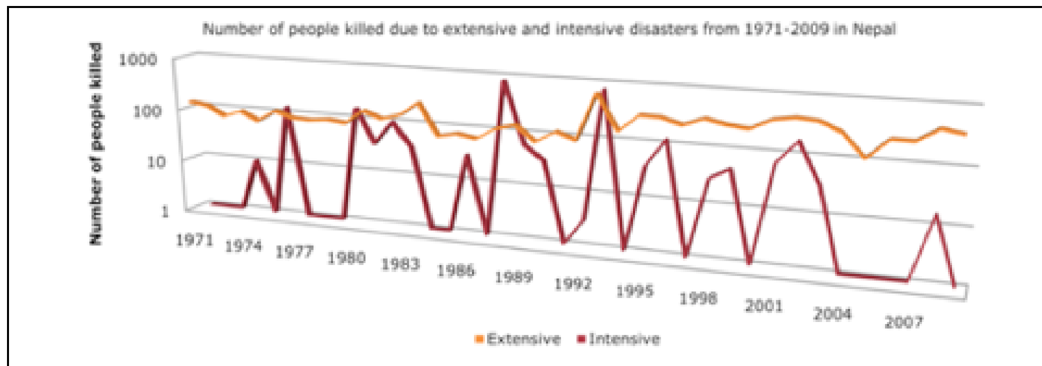
2.3 At the same time, cyclical, small-scale recurring events and conflict pose a continuous threat and erode communities' resilience. In fact, smaller and recurring disasters might cause more suffering overall than a few collective large-scale events. The UNISDR biennial study found in 2011 that extensive risk - recurrent small-scale disasters - had a greater impact on losses than intensive risk. The study said: "extensive risk account[ed] for 53.9% of houses damaged, 80% of people affected, 83.1% of people injured, 45.2% of damage to schools and 55.2% of damage to health facilities."[15] A similar message is conveyed in the table below from UNISDR, Asia-Pacific Disaster Report 2012, which shows that in Nepal, overall extensive risk (measured in the number of deaths) is much higher than irregular intensive shocks. This example typifies the balance between intensive and extensive risk around the world.



2.4 Members of the CBHA responded to 90 crises in 2012, which is indicative of the number of small- or medium-scale disasters that require support. Many events are predictable or cyclical and take place in different parts of one country. For example, CBHA agencies responded to 3 different crises in Colombia: floods; volcanic eruption; and protection of indigenous populations.

2.5 The UK Foresight report concludes that the effect of the main drivers of humanitarian crises and their interaction is complex and unpredictable, inevitably leading to more uncertainty.[16] The report advocates scientists and humanitarians to work together on building strategies around probabilistic scenarios. In addition, the Humanitarian Futures Programme at King's College London encourages agencies to think about the interconnections in systems, and the potential of novel shocks such as cybernetic failure to create humanitarian crises.[17]

2.6 This increased awareness that the demands of the future are extensive and complex is set within an economic paradigm of austerity, which makes support to the third sector unstable and unpredictable. Public giving rates may fall[18] while humanitarian spending by institutional donors has not been immune to budget cuts. Taken together, it is not clear how a higher humanitarian caseload will be matched by the required level of investment.

3. Challenges within the humanitarian system

3.1 NGOs today represent an extensive global network. For example, the 18 agency CBHA network, including international family members and partners, extends to nearly 6,889 organisations, operating in over 200 countries and territories, and assisting approximately 370 million people annually.[19] Added to this are incalculable levels of assistance provided by communities themselves to help people in crisis.

3.2 NGOs implement the majority of humanitarian assistance. Although there is little data available to evidence this argument due to lack of adequate transparency within several existing funding streams[20], the generally accepted estimate is that NGOs implement approximately 70% of all humanitarian assistance, even though

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most of it is indirectly financed (i.e. through UN sub contracts).[21] Hence, civil society organisations form a critical component of the end delivery of humanitarian assistance; many people in crises depend on the impartial and proactive capacity of NGOs.

3.3 However, critics argue that civil society is not always maximising its full potential to stimulate transformative change and resilience to humanitarian crises at the grass roots level. NGOs can be seen to have drifted into 'sub-contractor' roles, which prioritise upward accountability (to donors) instead of downward (to communities).[22]

3.4 This contracting trend is entrenched in the current business model for humanitarian aid. This business model hampers pro-active and impartial response, and instead creates several layers of dependency. Most international NGOs leverage privately raised resources into larger scale government donor contracts, whereas national and local organisations are even more dependent on (sub) contracts from donors or international NGOs.

3.5 In this business model, funding mostly becomes available when situations escalate. There is predictable suffering in many places around the world where there are never resources to address it. The East Africa crisis of 2011 illustrated the reactive nature of the system, as many stakeholders were aware of the unfolding crisis for a long time. Research has confirmed that it takes approximately 9 months for DFID to trigger a response to a spike in a protracted crisis, as the response is often through multilateral organisations.[23] Late response is expensive, and hence a few protracted crises absorb a large percentage of the humanitarian funding available. Funding for these crises dwarfs spending to build resilience, finance preparedness or support disaster risk reduction initiatives. Indeed, funding for the latter programmes accounted for only 0.5% of non-humanitarian Overseas Development Assistance (ODA) from 2006-2011.[24]

3.6 Analysis of trends in a number of neglected crises by LSE graduate students indicates numerous similarities.[25] Neglected crises are for instance commonly based in former British colonies, dominated by a single religion and based in a wider economy that is service based (instead of depending heavily on agriculture or industry). These parallels could point to a deficiency of needs-based decision making which leave certain crises neglected but the causalities at play need to be researched further.

3.7 In more detail, the present funding architecture creates the following blockages for effective civil society action:

3.7.1 The first problem is that NGOs receive a lot of their funding indirectly. Institutional funding is increasingly being channelled through the UN and UN-managed pooled funds, which leaves a gap in the system. In 2011, 84% of DFID humanitarian funding was allocated to the UN, while just 7% was allocated directly to NGOs.[26] This is a broad trend evidenced across most OECD donors. National and local organisations in the South struggle even more to access funds directly, and are dependent on their relationships with international organisations (UN or International NGOs).

3.7.2 Secondly, indirect funding slows humanitarian action down, making early (to prevent) and timely (to respond) interventions difficult to achieve. The average time it takes for civil society organisations to receive pass-through funding from the Central Emergency Revolving Fund (CERF) via a UN agency is 13

[21] ALNAP (2012) stated that CSOs implemented $7.4bn humanitarian assistance, while the UN implemented $9.3bn and the Red Cross/Crescent Movement 1.2bn (p. 26). However, this does not include any funds that UN agencies subcontract to NGOs which we estimate to be approx. 40% based on indicatory data from UNHCR & WFP. This would bring the NGO proportion total to $11.1bn, whereas overall humanitarian flows are estimated by the OCHA FTS at $16b in 2010. Thus NGO implementation could crudely account for 70% of this total.

[22] Banks, Nicola & David Hulme, The role of NGOs and civil society in development and poverty reduction, Brooks World Poverty Institute Working Paper 171, University of Manchester, June 2012; See also work of Michael Edwards: http://futurepositive.org/; Anderson, Mary B., Dayna Brown and Isabella Jean, Time to Listen: hearing people on the receiving end of international aid, CDA Collaborative Learning Projects, Cambridge Massachusetts, November 2012.

[23] Venton et all, The Economics of Early Response and Disaster Resilience, 2012.

[24] Development Initiatives, Global Humanitarian Assistance Report 2011.

[25] Jones, I., Megan Rein, Karen Warner and Carley White, Putting the Pieces Together: an analysis of neglect, LSE research project, 2013.

[26] Sutton et all, 2013, p. 9: Comparison of humanitarian funding allocations to selected OECD countries in 2010 and 2011.

weeks for 'rapid response' and 19 weeks for underfunded emergencies.[27] There are similar delays with the Common Humanitarian Funds (CHFs) and Emergency Response Funds (ERFs) in the countries where they are deployed (5 CHFs and 13 ERFs). The 2012 Global ERF evaluation found that the time between formal receipt of an application to the issuance of the first payment averaged between 45 and 70 days, indicating that the ERF is not a first responder.[28] Nevertheless, the global evaluation considered the ERF still a significantly faster mechanism than bilateral donors like the European Community Humanitarian Office (ECHO) and Office of U.S. Foreign Disaster Assistance (OFDA).[29]

3.7.3 Third, implementation is becoming unaffordable for not for profit organisations. Organisations lose time and money on unsuccessful grants, donor contracts require considerable management investments from implementing agencies, while 'cascading overheads' leave little funding for overheads directly associated with implementation.[30] For example, the CERF fund passes through the UN Secretariat, which takes 3% in overheads, then the funds are allocated to a UN agency which can take up to another 7% in overheads.[31] Therefore before reaching the implementing partner, up to 10% of funds may have been spent on administration. Consequently, funders place a limit on the indirect field costs that can be covered by directly implementing agencies. This poses a significant challenge for NGOs, as their actual required overhead rate is closer to 15-20%. In effect, this means NGO contracts demand a subsidy from private donations which is not sustainable for most organisations (especially at the national and local level), and would for example be unacceptable to private sector contracting firms.[32]

3.8 In response to the Humanitarian Emergency Response Review of 2011, DFID established the Rapid Response Facility (RRF) in 2012, to enable fast response to rapid onset disasters through pre-qualified NGOs partners. The RRF was activated once that year to address a cholera outbreak in Sierra Leone; NGO partners made several additional requests to DFID to trigger the RRF (for example, in response to the Upper Nile crisis, South Sudan and to Haiti Hurricane Sandy), but no other crisis was found to be a suitable match. This indicates that the RRF is designed to cover a niche area of humanitarian crises and does not resolve the challenge around the pro-active and impartial capacity of NGOs that has been identified.

3.9 Previously this paper indicated that humanitarian funds will be stretched even further in the future, and 'new aid' will not per definition solve this problem or strengthen impartial proactive action by NGOs, who focus on the most vulnerable people. Newly emerging economic powers show little opposition to spending money where it also suits their national interests; and similarly, it may be difficult for private sector corporations to manage their philanthropic and business interests separately. This leaves private donations as the main source for 'impartial funding', but one to one aid (through platforms like Kiva, for example) is becoming increasingly popular over institutional emergency assistance.

3.10 Populations affected by crises will continue to depend on the impartial and needs-based approach of civil society actors, and hence civil society's role should be changed and strengthened. To enable a resilient ecosystem to flourish, NGOs will need a business model that enables them to re-connect to local civil society as facilitators and supporters, so that communities themselves can engage in dialogue and negotiations to enhance their collective assets and capabilities.[33] This requires different funding structures that strengthen local capacity and increase the effectiveness of international support.

[27] Channel Research, Five-Year Evaluation of CERF, Final Synthesis Report, 2011.
[28] Global ERF evaluation, Universalia, 2012, pp. 10, 11 and 38.
[29] Ibid., p. 26.
[30] Stoddard, International Humanitarian Financing: Review and Comparative Assessment of Instruments, 2008, p. 28.
[31] Channel Research, 2011, p. 845 – 850.
[32] It is unknown what the allowed overhead rates are for private sector companies and NGOs would appreciate transparency on this issue from the standpoint that such rates ought to be commensurate.
[33] Ibid., p. 2. See also publications by Oxfam (2012) and Christian Aid (2012) describing the future humanitarian world order.

4. NGO effort to transform the business model

4.1 There are efforts underway which aim to address some of the described challenges to civil society in humanitarian action. One effort is to create a multi-donor[34], global humanitarian fund, managed by and for civil society, called the Start Fund. The Start Fund is led by a consortium of 18 NGOs, focusses on timely funding for frontline NGOs and CBOs in rapid onset crises, and it will provide early funding in slow onset crises. This will fill a crucial gap and thereby complement the existing financial architecture. The evidence from a DFID-funded pilot is that this sort of collective NGO effort can be effective and provide good value for money for the British taxpayer.

4.2 The evidence underpinning the Start Fund is based on the CBHA Emergency Response Fund pilot (2010-2012), funded by DFID with £4 Million. This pilot fund disbursed funding via a peer-review mechanism within 72 hours to 12 different crises, where operations started within 7 days and were completed within 30 days. The evaluation of the two-year pilot applauded the early, fast and cost-effective attributes of the fund.[35] It concluded that financing the initial response to small-scale emergencies, as the CBHA pilot did, especially with national staff or local NGOs/CBOs, preserves capacity in the system, "making them better prepared and resilient when large scale emergencies occur."[36] The recent Chatham House study on translating early warning into early response also highlighted the effectiveness of the fund, particularly in the 2011 Horn of Africa crisis, when it disbursed money several months ahead of the declaration of famine.[37]

4.3 The design of such mechanisms is fundamental to achieving effective humanitarian response in a rapidly changing world. Start Fund will not earmark funding to certain crises, although its main emphasis will be on extensive risk, the frequent small and medium sized emergencies that lack the visibility required to trigger international finance mechanisms. The future structure for the Start Fund will consist of a network of appropriately governed and resourced local funds with better access to the full ecosystem of civil society humanitarian responders: local, national and international. The CBHA believes humanitarian leadership should be local, supported by international organisations according to the principle of subsidiarity.

5. Conclusion

5.1 Initiatives that strengthen the independent capacity of civil society are important in a multipolar humanitarian system. This is not to obviate the importance of states as duty-bearers of the right of all people to receive humanitarian assistance. A resilient humanitarian system will need a range of mechanisms, while allowing different actors to maximise their potential to collaborate and contribute. An independent civil society mechanism will in some instances ensure that the core principle of impartiality in the provision of humanitarian assistance is upheld. The UK has explicitly and repeatedly committed to this core principle since 1991[38] and hence might be interested in opportunities that further the implementation of this principle in practice worldwide.

June 2013

[34] The fund will draw from humanitarian bilateral donors (both traditional and newly emerging), major private philanthropy and matched contributions by members.

[35] DARA, Evaluation of the Consortium of British Humanitarian Agencies Pilot, 2012, p. 13.

[36] Ibid. 2012, p. 12.

[37] Chatham House Report, R.Bailey, Managing Famine Risk: Linking Early Warning to Early Action, 2013, p. 65.

[38] GA Resolution 46/182

Written evidence submitted by Consortium of British Humanitarian Agencies

About the Consortium of British Humanitarian Agencies (CBHA)
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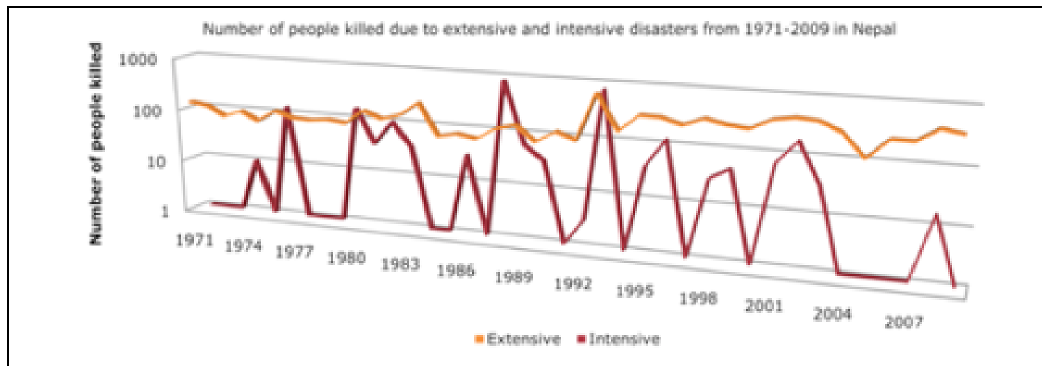

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3.3 However, critics argue that civil society is not always maximising its full potential to stimulate transformative change and resilience to humanitarian crises at the grass roots level. NGOs can be seen to have drifted into 'sub-contractor' roles, which prioritise upward accountability (to donors) instead of downward (to communities).[22]

3.4 This contracting trend is entrenched in the current business model for humanitarian aid. This business model hampers pro-active and impartial response, and instead creates several layers of dependency. Most international NGOs leverage privately raised resources into larger scale government donor contracts, whereas national and local organisations are even more dependent on (sub) contracts from donors or international NGOs.

3.5 In this business model, funding mostly becomes available when situations escalate. There is predictable suffering in many places around the world where there are never resources to address it. The East Africa crisis of 2011 illustrated the reactive nature of the system, as many stakeholders were aware of the unfolding crisis for a long time. Research has confirmed that it takes approximately 9 months for DFID to trigger a response to a spike in a protracted crisis, as the response is often through multilateral organisations.[23] Late response is expensive, and hence a few protracted crises absorb a large percentage of the humanitarian funding available. Funding for these crises dwarfs spending to build resilience, finance preparedness or support disaster risk reduction initiatives. Indeed, funding for the latter programmes accounted for only 0.5% of non-humanitarian Overseas Development Assistance (ODA) from 2006-2011.[24]

3.6 Analysis of trends in a number of neglected crises by LSE graduate students indicates numerous similarities.[25] Neglected crises are for instance commonly based in former British colonies, dominated by a single religion and based in a wider economy that is service based (instead of depending heavily on agriculture or industry). These parallels could point to a deficiency of needs-based decision making which leave certain crises neglected but the causalities at play need to be researched further.

3.7 In more detail, the present funding architecture creates the following blockages for effective civil society action:

3.7.1 The first problem is that NGOs receive a lot of their funding indirectly. Institutional funding is increasingly being channelled through the UN and UN-managed pooled funds, which leaves a gap in the system. In 2011, 84% of DFID humanitarian funding was allocated to the UN, while just 7% was allocated directly to NGOs.[26] This is a broad trend evidenced across most OECD donors. National and local organisations in the South struggle even more to access funds directly, and are dependent on their relationships with international organisations (UN or International NGOs).

3.7.2 Secondly, indirect funding slows humanitarian action down, making early (to prevent) and timely (to respond) interventions difficult to achieve. The average time it takes for civil society organisations to receive pass-through funding from the Central Emergency Revolving Fund (CERF) via a UN agency is 13

[21] ALNAP (2012) stated that CSOs implemented $7.4bn humanitarian assistance, while the UN implemented $9.3bn and the Red Cross/Crescent Movement 1.2bn (p. 26). However, this does not include any funds that UN agencies subcontract to NGOs which we estimate to be approx. 40% based on indicatory data from UNHCR & WFP. This would bring the NGO proportion total to $11.1bn, whereas overall humanitarian flows are estimated by the OCHA FTS at $16b in 2010. Thus NGO implementation could crudely account for 70% of this total.

[22] Banks, Nicola & David Hulme, The role of NGOs and civil society in development and poverty reduction, Brooks World Poverty Institute Working Paper 171, University of Manchester, June 2012; See also work of Michael Edwards: http://futurepositive.org/; Anderson, Mary B., Dayna Brown and Isabella Jean, Time to Listen: hearing people on the receiving end of international aid, CDA Collaborative Learning Projects, Cambridge Massachusetts, November 2012.

[23] Venton et all, The Economics of Early Response and Disaster Resilience, 2012.

[24] Development Initiatives, Global Humanitarian Assistance Report 2011.

[25] Jones, I., Megan Rein, Karen Warner and Carley White, Putting the Pieces Together: an analysis of neglect, LSE research project, 2013.

[26] Sutton et all, 2013, p. 9: Comparison of humanitarian funding allocations to selected OECD countries in 2010 and 2011.

weeks for 'rapid response' and 19 weeks for underfunded emergencies.[27] There are similar delays with the Common Humanitarian Funds (CHFs) and Emergency Response Funds (ERFs) in the countries where they are deployed (5 CHFs and 13 ERFs). The 2012 Global ERF evaluation found that the time between formal receipt of an application to the issuance of the first payment averaged between 45 and 70 days, indicating that the ERF is not a first responder.[28] Nevertheless, the global evaluation considered the ERF still a significantly faster mechanism than bilateral donors like the European Community Humanitarian Office (ECHO) and Office of U.S. Foreign Disaster Assistance (OFDA).[29]

3.7.3 Third, implementation is becoming unaffordable for not for profit organisations. Organisations lose time and money on unsuccessful grants, donor contracts require considerable management investments from implementing agencies, while 'cascading overheads' leave little funding for overheads directly associated with implementation.[30] For example, the CERF fund passes through the UN Secretariat, which takes 3% in overheads, then the funds are allocated to a UN agency which can take up to another 7% in overheads.[31] Therefore before reaching the implementing partner, up to 10% of funds may have been spent on administration. Consequently, funders place a limit on the indirect field costs that can be covered by directly implementing agencies. This poses a significant challenge for NGOs, as their actual required overhead rate is closer to 15-20%. In effect, this means NGO contracts demand a subsidy from private donations which is not sustainable for most organisations (especially at the national and local level), and would for example be unacceptable to private sector contracting firms.[32]

3.8 In response to the Humanitarian Emergency Response Review of 2011, DFID established the Rapid Response Facility (RRF) in 2012, to enable fast response to rapid onset disasters through pre-qualified NGOs partners. The RRF was activated once that year to address a cholera outbreak in Sierra Leone; NGO partners made several additional requests to DFID to trigger the RRF (for example, in response to the Upper Nile crisis, South Sudan and to Haiti Hurricane Sandy), but no other crisis was found to be a suitable match. This indicates that the RRF is designed to cover a niche area of humanitarian crises and does not resolve the challenge around the pro-active and impartial capacity of NGOs that has been identified.

3.9 Previously this paper indicated that humanitarian funds will be stretched even further in the future, and 'new aid' will not per definition solve this problem or strengthen impartial proactive action by NGOs, who focus on the most vulnerable people. Newly emerging economic powers show little opposition to spending money where it also suits their national interests; and similarly, it may be difficult for private sector corporations to manage their philanthropic and business interests separately. This leaves private donations as the main source for 'impartial funding', but one to one aid (through platforms like Kiva, for example) is becoming increasingly popular over institutional emergency assistance.

3.10 Populations affected by crises will continue to depend on the impartial and needs-based approach of civil society actors, and hence civil society's role should be changed and strengthened. To enable a resilient ecosystem to flourish, NGOs will need a business model that enables them to re-connect to local civil society as facilitators and supporters, so that communities themselves can engage in dialogue and negotiations to enhance their collective assets and capabilities.[33] This requires different funding structures that strengthen local capacity and increase the effectiveness of international support.

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[27] Channel Research, Five-Year Evaluation of CERF, Final Synthesis Report, 2011.
[28] Global ERF evaluation, Universalia, 2012, pp. 10, 11 and 38.
[29] Ibid., p. 26.
[30] Stoddard, International Humanitarian Financing: Review and Comparative Assessment of Instruments, 2008, p. 28.
[31] Channel Research, 2011, p. 845 – 850.
[32] It is unknown what the allowed overhead rates are for private sector companies and NGOs would appreciate transparency on this issue from the standpoint that such rates ought to be commensurate.
[33] Ibid., p. 2. See also publications by Oxfam (2012) and Christian Aid (2012) describing the future humanitarian world order.

4. NGO effort to transform the business model

4.1 There are efforts underway which aim to address some of the described challenges to civil society in humanitarian action. One effort is to create a multi-donor[34], global humanitarian fund, managed by and for civil society, called the Start Fund. The Start Fund is led by a consortium of 18 NGOs, focusses on timely funding for frontline NGOs and CBOs in rapid onset crises, and it will provide early funding in slow onset crises. This will fill a crucial gap and thereby complement the existing financial architecture. The evidence from a DFID-funded pilot is that this sort of collective NGO effort can be effective and provide good value for money for the British taxpayer.

4.2 The evidence underpinning the Start Fund is based on the CBHA Emergency Response Fund pilot (2010-2012), funded by DFID with £4 Million. This pilot fund disbursed funding via a peer-review mechanism within 72 hours to 12 different crises, where operations started within 7 days and were completed within 30 days. The evaluation of the two-year pilot applauded the early, fast and cost-effective attributes of the fund.[35] It concluded that financing the initial response to small-scale emergencies, as the CBHA pilot did, especially with national staff or local NGOs/CBOs, preserves capacity in the system, "making them better prepared and resilient when large scale emergencies occur."[36] The recent Chatham House study on translating early warning into early response also highlighted the effectiveness of the fund, particularly in the 2011 Horn of Africa crisis, when it disbursed money several months ahead of the declaration of famine.[37]

4.3 The design of such mechanisms is fundamental to achieving effective humanitarian response in a rapidly changing world. Start Fund will not earmark funding to certain crises, although its main emphasis will be on extensive risk, the frequent small and medium sized emergencies that lack the visibility required to trigger international finance mechanisms. The future structure for the Start Fund will consist of a network of appropriately governed and resourced local funds with better access to the full ecosystem of civil society humanitarian responders: local, national and international. The CBHA believes humanitarian leadership should be local, supported by international organisations according to the principle of subsidiarity.

5. Conclusion

5.1 Initiatives that strengthen the independent capacity of civil society are important in a multipolar humanitarian system. This is not to obviate the importance of states as duty-bearers of the right of all people to receive humanitarian assistance. A resilient humanitarian system will need a range of mechanisms, while allowing different actors to maximise their potential to collaborate and contribute. An independent civil society mechanism will in some instances ensure that the core principle of impartiality in the provision of humanitarian assistance is upheld. The UK has explicitly and repeatedly committed to this core principle since 1991[38] and hence might be interested in opportunities that further the implementation of this principle in practice worldwide.

June 2013

[34] The fund will draw from humanitarian bilateral donors (both traditional and newly emerging), major private philanthropy and matched contributions by members.

[35] DARA, Evaluation of the Consortium of British Humanitarian Agencies Pilot, 2012, p. 13.

[36] Ibid. 2012, p. 12.

[37] Chatham House Report, R.Bailey, Managing Famine Risk: Linking Early Warning to Early Action, 2013, p. 65.

[38] GA Resolution 46/182

Written evidence submitted by the Overseas Development Institute

1. The long term relevance of the 0.7% ODA target

1.1 The 0.7% target was first agreed under the auspices of the UN in 1970. It has never been a strongly evidenced target, more a political tool, which implies that discussions about changing it will be at least as much political in nature as technical. A range of factors imply that the current definition and target of ODA are no longer fit for purpose.

1.2 Studies suggest that extreme poverty is continuing to decline rapidly, although there is continued discussion about the likely future "geography of poverty" (Sumner 2010, Kharas and Rogerson 2012).

1.3 Most developing countries are increasingly moving away from reliance on aid, even in Africa (Actionaid 2012, Glennie 2008), which raises questions over whether there will still be demand for traditional aid in the future.

1.4 Amongst the broader goals (beyond poverty reduction) that future ODA could help to mobilise finance for the provision of are addressing climate change and environmental sustainability, global health challenges and security – often grouped under the heading Global Public Goods (GPGs) (Severino 2009, ODI forthcoming). The implications of a more ambitious agenda addressing GPGs alongside poverty reduction might be the need for more resources overall, and the need to focus even on countries where extreme poverty is no longer prevalent.

1.5 The growing volume of development assistance coming from Southern donors and new development cooperation actors is a crucial additional factor. ODI estimates that these flows were equivalent to at least 30% of OECD donor contributions in 2011 and are growing fast (Greenhill et al 2013). ODI's Claire Leigh and Jonathan Glennie have proposed that all countries, even the poorest, might contribute something to global development financing in the future (Leigh and Glennie 2013).

1.6 This discussion began some time before the process of agreeing development goals to succeed the MDGs and a package of measures to pursue them (for example see Severino 2009), but has been given added impetus by this process.

1.7 There appear to be two broad scenarios. Either aid gradually declines as poverty is reduced globally and countries rely more on non-concessional flows. Or aid continues to be of importance, as objectives multiply and the unique character of public finance at a global level is considered important. In the former scenario, the 0.7% target would seem too high; in the latter it may not be sufficient.

2. The suitability of DFID's mix of financial instruments, including its use of loans and traditional grant aid

2.1 DFID does not currently deliver any of its ODA in the form of loans, although its grant contributions to a number of multilateral institutions are lent on to developing countries. However, the share of loans in total ODA has been on a gradually increasing trend since 2007 and reached just over 20% in 2011 (Tew 2013).

2.2 There are a number of arguments commonly put forward in favour of providing ODA in the form loans rather than grants, including their ability to mobilise large levels of upfront resources for countries (an effect which is neutralised over the length of the loan due to repayments) and possible disciplining effects on the use of resource use by recipients (which is disputed in the literature) (Tew 2013).

2.3 The major downside to ODA loans is that they have to be repaid and therefore require developing countries to divert resources away from public spending towards such repayments. This issue retains major relevance in many developing countries, as debt levels have increased since the global economic crisis. Aid levels stagnated during this period and developing countries have had to rely on loans for around 40% of the resources they have raised to compensate for the falls in revenue (DFI and Oxfam 2013).

2.4 These characteristics of loans suggest that grants are more suitable for countries with lower levels of income, higher levels of inherited debt, higher risk of economic volatility and limited fiscal capacity (Baudienville et al 2009). Although countries with these characteristics tend to be those in the low income category, it would also be the case for many MICs, given the breadth of the middle income country (MIC) category (which covers countries with annual incomes between $1,026 and $12,475). Country classifications are now, in fact, a questionable tool for making such financing decisions (Glennie 2011).

2.5 Much of the impact of loans on the resources of developing countries will depend on the terms of the loan being provided. There are a range of ways in which donors can lessen this impact and ensure a loan is concessional, including charging below market interest rates, providing lengthy repayment periods and blending loans with grants. It is vital that donors use such approaches to tailor loans to country needs and challenges.

2.6 **These conclusions point to the need for DFID to address any question on the use of loans and their concessionality on the basis of the portfolio of countries it wishes to provide assistance to and robust assessments of their economic and financial capacity to manage loans.**

2.7 The characteristics of loans also point towards there being a stronger case for grants to fund projects that do not generate revenues (like private sector and infrastructure investments) and involve higher risks (Baudienville et al). **As a result DFID's policy on loans may also need to be informed by decisions on the mix of such activities in its portfolio.**

3. Role of the UK as a provider of climate finance

3.1 The UK's climate finance contribution is of vital importance to helping developing countries incorporate climate change into their development strategies. The UK has played a critical leadership role in global efforts to mobilise funding to this end, consistent with commitments made under the UN Framework Convention on Climate Change to scale up climate finance in the context of securing ambitious global collective action on climate change (Nakhooda et al 2012). It is crucially important for the UK to continue to deliver climate finance in support of these commitments, and to continue to make progress on options for scaling up the level of support that it is delivering, while continuing to strengthen the effectiveness of the support that it delivers.

3.2 There is substantial interest in how climate finance can be used to enable fundamental transitions to climate compatible development in developing countries. There is particularly interest in the role that climate finance can play in mobilizing private sector investment in low carbon and climate resilient approaches (Whitley 2012). There is an important role for public climate finance in supporting public sector institutions to explore and implement necessary changes and improvements to underlying policies and regulatory frameworks that will make climate compatible development more viable

(Nakhooda 2013). Such support may be usefully delivered through grants that support the budgets of key institutions and capacity building initiatives. There may also an important role for grants in supporting research and engagement with non-governmental institutions within countries that can support and inform more ambitious and effective action on climate change within developing countries (Whitley 2011, Nakhooda 2013).

3.3 Different interventions to support climate change entail different costs, risks, and different actors can play different roles. There is a strong case to be made for tailoring instruments to the particular risks and needs that a climate related intervention entails (Nakhooda 2013). By mobilising climate finance contributions as grants and capital grants, implementing agencies can use this funding in a discretionary way to address these risks in a tailored fashion. We observe that the decisions of some countries to capitalize multilateral climate funds such as the Clean Technology Fund with low cost loans has in some cases significantly constrained the risks that the fund is able to bear (for example, in some cases the risks associated with local currency lending for clean energy projects in developing countries were seen as too high for the loan capitalization to bear). There is a need to continue to ensure that climate finance can be used to bear a diversity of risks and costs, and to allow flexible and innovative approaches to program design.

4. Whether the UK should establish a new, independent development finance institution to offer concessional loans?

4.1 Development finance institutions (DFIs) play an important role in the international cooperation system through their provision of support to the private sector, catalysing private investment, providing counter cyclical funding during economic crises and delivering technical assistance (te Velde 2011). In providing this type of support DFIs have been found to contribute to increases in foreign direct investment (te Velde and Warner 2007), productivity, employment and economic growth (Jouanjean and te Velde 2013).

4.2 The establishment of a new independent UK development finance institution to offer concessional loans would be a major undertaking by the UK Government, and it is therefore vital that a number of important questions are addressed before such a decision is made.

4.3 Firstly, it will be important that any decision is informed by an assessment of the financing needs of the UK's development partners and how / whether such an institution will address these needs. As highlighted in section 2 this should in part be based on assessing the degree to which these partners require and are in a position to manage the financial consequences of loans. This should also involve understanding the degree to which its partners require the types of financing tools that DFIs commonly provide, including loans, guarantees and equity investments.

4.4 Assuming that the UK's development partners would benefit from greater access to the type of support provided by DFI's it will be important to establish what the value added of establishing such an institution will be in comparison to other bodies – both in the UK and beyond - that are currently operating in this space, including multilateral agencies, development finance institutions and private sector actors. If these actors are better equipped to respond to these challenges and are motivated to and likely to be successful in scaling-up their efforts then channelling support through them would likely be preferable.

5. DFID's balance between provision of bilateral and multilateral aid?

5.1 DFID's Multilateral and Bilateral Aid Reviews have made an important contribution to the UK Government's (and broader donor) efforts to assess the performance of these aid delivery channels and to inform decisions allocating aid across them. However, IDC will be well aware of the results of these reviews, so this section of our submission will focus on highlighting some additional insights relevant to questions, especially on the relative performance of multilateral aid agencies.

5.2 There has rightly been increasing attention on the administration costs of the various multilateral agencies, but it is important to recognise that the cost effectiveness of these organisations goes beyond this relatively narrow element. Multilateral agencies have some inherent characteristics that contribute to promoting cost effectiveness. These include reducing the aid management burdens for recipients by coordinating support from a number of donors, their delivery of untied aid and their potential to achieve economies of scale in managing aid programmes.

5.3 There have been a number of attempts beyond the MAR to assess the effectiveness of multilateral aid agencies, including ones that judge them relative to bilateral agencies. These suggest that multilateral aid agencies perform at least as well as bilateral aid agencies in relation to the Paris Declaration on Aid Effectiveness principles and commitments (OECD 2011) and may well be outperforming bilateral agencies in relation to an even broader set of criteria (Easterly and Pfutze 2008, CGD 2011).

5.4 In relation to the value added of regional development banks an important aspect of their functioning revealed by a 2007 survey by ODI was a perception by recipient countries that their closer role in the governance of these agencies has helped to shape their greater sense of ownership of their programmes (Burrall 2007).

5.5 Recent research by ODI has also illustrated how developing countries value the speed of response and delivery of some emerging donors (Greenhill et al 2013), which highlights the need for multilateral agencies to address obstacles to delivering their assistance more rapidly.

5.6 Finally, an element of the value added of multilateral agencies that is becoming more prominent and may give them renewed significance in the coming years is that relating to their response to GPGs. Addressing needs relating to GPGs benefits from the ability of multilateral agencies to pool contributions from a large range of actors in support of a coordinated response to development challenges (ODI forthcoming). Multilateral agencies are already playing such a role in relation to climate change, where bodies such as the Climate Investment Funds are leading global efforts to support country efforts to adapt and mitigate the effects of climate change.

5.7 It is important that future assessments of the performance of multilateral agencies that feed into aid allocation decisions take into account all relevant factors, including their evolving role in the international cooperation system.

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Written evidence submitted by Christian Aid

1. Introduction

1.1 Christian Aid is a Christian organisation that insists the world can and must be swiftly changed to one where everyone can live a full life, free from poverty. We work globally in 45 countries for profound change that eradicates the causes of poverty, striving to achieve equality, dignity and freedom for all, regardless of faith or nationality. We are part of a wider movement for social justice. We provide urgent, practical and effective assistance where need is great, tackling the effects of poverty as well as its root causes.

1.2 In the current world context, in which development cooperation is changing dramatically, we appreciate the need to review and adapt how UK ODA can most effectively be used. This submission sets out Christian Aid's priority recommendations for the International Development Committee to consider in its inquiry into the future of UK development cooperation. It covers the following points:

- Whether the 0.7% ODA target will be appropriate in the long term;
- Whether DFID has the right mix of financial instruments and whether it should introduce new ones, including concessional loans; the balance between loans and traditional grant aid; and the role of the UK as a provider of climate finance;
- Whether DFID has the right balance between bilateral and multilateral aid; and
- How DFID should monitor and influence expenditure by multilateral institutions, including in countries and regions where DFID does not have bilateral programmes.

1.3 We welcome the opportunity to provide written evidence to the International Development Committee on this, and are happy to provide further written/oral evidence on any of the subjects covered in this submission via Barry Johnston, Senior UK Political Adviser (email: bjohnston@christian-aid.org).

2. The appropriateness of 0.7% ODA target in the long term:

2.1 Christian Aid applauds the Government for reaching the cross-party pledge to spend 0.7% GNI for overseas aid this year and strongly believes that this level should be maintained into the future. Academic analysis suggests that a key determinant of aid impact is predictable financing. Aid at present is notoriously unpredictable, with commitments made and not met, and frequent reversals over time rather than steady flows to individual countries. **The UK Government should commit to providing a consistent level of ODA, and the best way to ensure this in the short to medium term is to deliver on the cross party consensus to enshrine the 0.7% target in legislation.**

2.2 A long term commitment to 0.7% ODA expenditure is morally right. It will also ensure that the UK remains an influential actor in global development and positions it as a leader among its G20 peers. **The UK Government should also continue to urge its G20 counterparts to meet their development commitments.**

2.3 As much as implementation of the 0.7% target is important, it is also vital that this funding remains clearly and directly focused on poverty eradication. Recent reports suggest there is pressure to broaden areas where the money can be spent to include such things as military peacekeeping missions. **Christian Aid would also stress that the definition of overseas aid must not be diluted and in particular the delivery mechanism should be primarily via DFID.**

2.4 In the longer term, UK development cooperation must be driven by the understanding that aid is a vital but partial response to poverty and inequality and can be undermined by other factors. Aid transforms the lives of millions of people, but alone it will never end poverty and there will never be enough aid. The falls in global aid flows in 2011 and again in 2012 demonstrate the lack of certainty for developing countries relying on aid[1] while even at their highest point, aid flows were dwarfed by illicit financial flows out of developing countries[2]. While vehemently defending and ensuring the impact and effectiveness of aid in the short to medium term, over a longer trajectory, the UK must develop credible and timelined strategies for assisting developing countries to graduate from aid dependency[3]. To achieve this requires tackling the structural causes of poverty alongside aid interventions.

2.5 It is clear that there is still a pressing need to increase resources for development, resources which may come from a number of channels including not just ODA (bilateral & multilateral) but also debt relief, growth of the domestic economy, Foreign Direct Investment (FDI) and tax revenues. However, all of these revenue sources can be undermined by capital flight and illicit financial flows. To take Nigeria as one example, it has been estimated that the amount lost through illicit financial flows in 2009 was $33.4 billion[4]. This can be compared to the $16.59 billion which Nigeria received in ODA that year. **In line with the recent recommendations of the IDC report on Tax in Developing Countries, Christian Aid urges the UK to invest in scaling up its work supporting developing countries to tackle tax avoidance, and other illicit financial flows.**

3. Whether DFID has the right mix of financial instruments and whether it should introduce new ones, including concessional loans; the balance between loans and traditional grant aid:

3.1 Christian Aid will not comment specifically on the introduction of concessional loans and their balance with grant aid, as, to date, we do not have experience either in offering loans or in analysing loaning functions. However, the experiences drawn from our programme work leads us to highlight some broad points.

3.2 The right mix of financial mix instruments must be assessed in relation to the goal itself of poverty eradication. Each instrument has its own cost benefit analysis and intended and unintended impacts. In determining the appropriate variety of instruments, the goals and drawbacks of different instruments, their complementariness and which instruments work most effectively in which developing country setting needs to be well-understood. Instruments not mentioned in the proposed list are diaspora bonds and public private finance initiatives which can be complementary to ODA, but again, where intended and unintended impacts need to be understood.

3.3 Well designed loans may be able to make a positive contribution within a broad mix of development finance instruments in some circumstances, but our experience shows that loans are not well suited to reach some of the poorest people. One of the major constraints facing poor producers is access to credit, but the very small levels of finance that they require can only very rarely be provided by institutional donors which are not able to operate at that level. At the same time, a wide range of support services for individual enterprises and poor producers to enter the value chain as well as systemic interventions on market functioning are also needed, but these are

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[1] http://www.oecd.org/dac/stats/aidtopoorcountriesslipsfurtherasgovernmentstightenbudgets.htm
[2] http://iffdec2011.gfintegrity.org/
[3] While we have limited our comments here to long-term development cooperation, there will always be some need for humanitarian/emergency response. The relationship between the two is dealt with more in Section 7.
[4] Global Financial Integrity:
http://www.gfintegrity.org/storage/gfip/documents/reports/IFFDec2011/illicit_financial_flows_from_developing_countries_over_the_decade_ending_2009.pdf P.39

unlikely to be suitable for credit finance. **The provision of finance through forms like concessional loans must not lead to policymakers overlooking the needs of the poorest who are currently hardest to reach and marginalised from financial markets.**

4. The role of the UK as a provider of climate finance:

4.1 On climate finance, the future development context will be shaped by an on-going environmental crisis. There is evidence that we have already put excessive pressure on many natural resources, including land, water, biodiversity and forestry. The increases in levels of climate unpredictability, constrained water resources and extreme weather are inevitable and *"tilted against many of the world's poorest regions"*[5]. **Sustainability, resilience to climate change and fair rights over resources must underpin future development cooperation that seeks to operate within planetary boundaries.**

4.2 To finance preparedness to both known and unpredictable environmental challenges, an appropriate channel of finance for developing countries is key. Large scale financing is urgently needed from developed countries, based on responsibility for emissions and capacity to pay. The continuation of the Green Climate Fund of the UNFCCC will determine how prepared developing countries are for responding to climate change. However progress in making the fund operational has been slow. The UK, one of the five G8 country's to sit on the fund's board, has earmarked 50% of its climate finance for adaptation, reflecting a global commitment to 'balance' financing between adaptation and mitigation. However, globally, financing of adaptation is receiving less than 20% of overall climate finance – an imbalance that needs to redressed. **The UK must urge other developed countries to ensure a balance in funding between mitigation and adaptation.**

4.3 The source of climate finance is also of concern, particularly the fact that most donors, including the UK, are taking their climate finance from aid budgets, in contradiction of their promises made at the UNFCCC. We believe that in the future national pledges of climate finance should be additional to ODA, and the UK should take a lead to establish and deliver innovative sources of reliable large scale finance. Since climate change needs to be dealt with alongside poverty reduction, climate finance should be additional to aid budgets, not taken from them. Further, much climate finance is in the form of loans not grants, which adds to developing countries debts and fails to reflect developed countries' historical responsibility for climate change. Undoubtedly, some of the funding for climate finance will need to come from new, innovative sources. There are a range of proposals here, including the domestic proposals for carbon taxes, re-direction of subsidies currently spent on fossil fuel extraction, the use of Special Drawing Rights (a form of international reserve currency) and a possible Financial Transaction Tax. **One promising innovative financing source that could raise significant climate finance is carbon pricing for international shipping; a major and rapidly growing source of greenhouse gas emissions. The UK government has already welcomed progress towards establishing a global regime for reducing emissions from shipping, suggesting that carbon pricing could be part of the solution.**

4.4 Policymakers are now exploring ways to encourage private sector finance for climate action in developing countries, i.e. investment in projects to reduce greenhouse gas emissions and build capacity to adapt to climate change impacts. The UK's recently launched Climate Public Private Partnership is one such example. Using public funds to leverage private finance is also an option being considered in allocating some of the funds channelled through the new Green Climate Fund, where a Private Sector Facility is now being developed. **Whatever the source and channel of climate finance, it is vital to ensure that adequate and reliable climate finance reaches the poorest and most vulnerable people, that its impacts can be clearly evaluated and monitored, and that**

[5] http://www.worldbank.org/en/news/feature/2012/11/18/Climate-change-report-warns-dramatically-warmer-world-this-century

adequate social, environmental and human rights safeguards are in place to protect recipient communities.

4.5 Christian Aid, along with other NGOs, has had a consistent call for climate finance to be delivered through country defined strategies, and that these strategies must involve civil society and affected communities in development, delivery and monitoring. **There must also be clear accountability to the taxpayer for the use of any public monies. Christian Aid also believes that there should be civil society involvement in the monitoring of climate change adaptation programmes.**

5. Whether DFID has the right balance between bilateral and multilateral aid:

5.1 Whether aid is delivered bilaterally or multilateral models are used, Christian Aid believes that the effectiveness of the disbursing agency and how funding is used (rather than the overall level) should be the determining factor. This assumes a new importance now as DFID considers the implications of a greater number of developing countries moving into middle income classification status. DFID's shift of bilateral funding from middle income country recipients to least development country recipients, part of a wider trend among bilateral funders, has far reaching impacts which need to be considered in assessing the mix between bilateral and multilateral aid.

5.2 Global inequality is persistent, with 20 per cent of the population enjoying more than 70 per cent of total income. Inequalities within countries are as important as between countries. Simplistic talk of 'rich north' and 'poor south' no longer makes sense. The majority of people living in poverty today are living in middle-income countries such as India, and it is in such countries that we are also seeing the greatest increase in inequality. Longstanding forms of inequality and discrimination such as those based on gender or ethnicity continue to limit the lives and opportunities of billions. Inequality has to be the primary paradigm through which we see future development cooperation and the UK's role must take greater account of this. **If DFID is no longer funding bilaterally in MICs, it is essential that multilateral models are adequately supported to address inequalities that make and keep people in poverty.**

5.3 The relevance and impact of UK development aid will also depend on how it addresses governance challenges across national borders and within developed and developing countries alike. Within the context of changing power relationships at all levels and across stakeholders – state and non-state actors, private sector and civil society – UK development cooperation should seek to promote governance, transparency and accountability that work for the poor majority, rather than serving the interests of the rich minority. **Again where DFID can no longer do this directly through bilateral programmes, it is important that the UK remain at the forefront of this work globally, including through multilateral funding.**

5.4 Bilateral funders often have greater degrees of political leverage in the countries that they lend to, and a movement away often leads to a deficit in such political capital. It is also important to note that leverage provided through aid budgets cannot always be substituted by other leverage e.g. trade. At the same time there is huge importance and benefit in multilateral funders extending reach into politically sensitive regions: in many developing countries multilateral organisations, including the EU, are often seen as a relatively neutral donor as compared with individual states such as the UK where history or current strategic interests might complicate a bilateral donor-recipient relationship. **We would stress that the key principle is the complementariness of both vehicles in individual country settings, rather than a fixed formula for proportionality of one form over the other.**

5.5 In terms of aid harmonisation, Christian Aid would encourage greater use of basket funding and pooled funding mechanisms across different thematic programmes including civil society support mechanisms. When this is well executed and there is strong donor collaboration, there are greater synergies, economies of scale and opportunities for learning across and between the ODA community, and ultimately greater impact at programme level. We have positive examples of this including a multi-donor resilience programme in Malawi and civil society voice and accountability programmes in Sierra Leone.

5.6 Within the mix of bilateral and multilateral aid, Christian Aid strongly believes that European Commission (EC) development cooperation remains a valuable and essential component of UK development assistance, and that it is vital that the UK continues to meet its commitments here. The effectiveness of EC aid has improved substantially over the past years, in part due to the establishment of specific financial instruments for development such as the European Development Fund and the Development Cooperation Instrument.

5.7 Christian Aid sees the added value of channelling funds through the EC as comprising a number of elements. It decreases the burden on recipient countries who have one, rather than a multiplicity of bilateral, donor administrative and other requirements, providing clear potential for increased efficiency, greater coordination and focus and hence value for money. EC aid is generally committed over multi-year frameworks and disbursed according to clear performance criteria. This predictability enables the recipient country to plan with confidence, providing greater potential to maximise impact. These are also applicable to other multilateral channels, and form a strong rationale for maintaining multilateral support.

6. How DFID should monitor and influence expenditure by multilateral institutions, including in countries and regions where DFID does not have bilateral programmes:

6. 1 DFID should continue to support effective use of multi-lateral channels in regions where it has few bilateral ODA priorities. In the case of the EU, monitoring and influence can be applied through the appropriate Brussels based mechanisms with liaison through FCO missions and EU delegations in-country. In the case of World Bank and Regional Development Bank institutions and UN agencies, monitoring and influence should be applied through the appropriate accountability mechanisms relating to these institutions. At the same time, the UK should push for greater transparency in this area to build support for this modality. **Christian Aid would also particularly note that monitoring and influence can be applied through smarter citizen and civil society accountability mechanisms at country level. Greater scrutiny of multi-lateral aid flows can be an incentive to use them more effectively.**

June 2013

Written evidence submitted by Simon Maxwell

What is the future of (UK) oda?

The building blocks of UK oda appear earthquake proof. However, there are tremors racing across the landscape which may shake political commitment and challenge current legislative frameworks.

The current building blocks include: a mission to reduce poverty in the developing world, underpinned by the 2002 Act and reinforced by the reporting requirements of the 2006 Act; a political commitment to 0.7, a figure that will be reached for the first time in the coming year and may also be underpinned by law, as promised by all political parties; and an international framework, agreed by the Development Assistance Committee of the OECD, which defines oda and lists eligible developing countries.

There are four perturbations to watch.

First, aid to middle income countries will become increasingly hard to defend. Second, it may be difficult to spend the aid available in remaining poor countries. Third, there are discussions about softening the definition of oda. And fourth, climate finance may swamp traditional aid and distort geographical priorities.

Working through these issues leads to three scenarios for the future of oda, each with legislative and political repercussions. Can political parties assume that the status quo will continue, effectively the best-case scenario? Should they assume another scenario? Or is the best bet to assume uncertainty, plan legislative changes in that context, and deliver a political message accordingly?

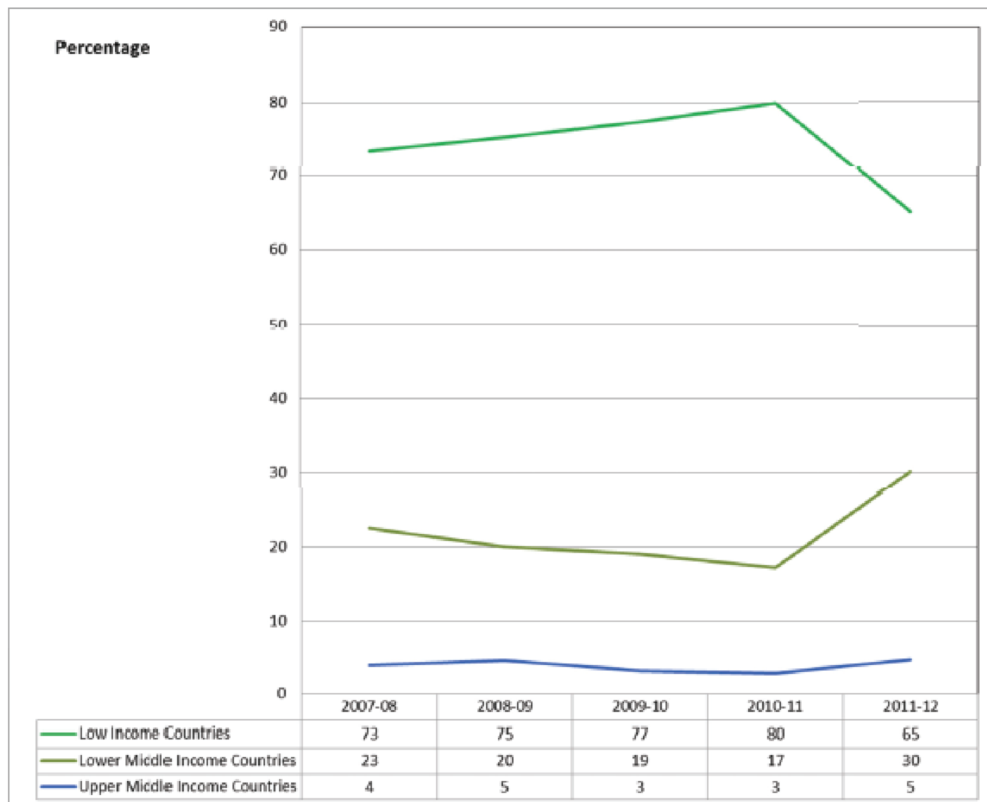
Will aid to middle income countries become increasingly hard to defend?

This is a familiar debate. However, the scale of the current challenge to aid agencies is illustrated by the following graph, supplied by the National Audit Office as background to support the Select Committee's Enquiry into the DFID Departmental Report for 2011-12. The graph shows a sharp fall in the share of bilateral aid going to low income countries, from 80% in 2010-11 to 65% in 2011-12. The NAO comments that 'the reduction in funding to Low Income Countries reflects the increasing sums the Department is spending in countries classified as Lower Middle Income Countries; some £791 million in 2011-12 (up 82 per cent on 2010-11 levels). Of its five largest programmes, three (India, Pakistan, and Nigeria) are in Lower Middle Income Countries, with Pakistan and Nigeria recently being reclassified from low income status'.

How much further will this curve fall? And how much should it fall? DFID, remember, used to have a target of spending 90% of bilateral aid in LICs, and used to point an accusing finger at the EU, whose share of spending on low income countries was below 50%. Will there be convergence?

Figure 5

The Department's bilateral aid (excluding humanitarian assistance) by country income group



	2007-08	2008-09	2009-10	2010-11	2011-12
Low Income Countries	73	75	77	80	65
Lower Middle Income Countries	23	20	19	17	30
Upper Middle Income Countries	4	5	3	3	5

NOTE

1. The Department also provides small amounts of aid to High Income Countries (£5 million in 2011-12, the equivalent of 0.2 per cent of the Department's total bilateral aid (excluding humanitarian assistance)).

Source: NAO presentation of data from the Department for International Development, Statistics On International Development 2007-08 – 2011-12, October 2012, page 71

The Select Committee commented on this, and concluded that

> 'DFID has switched expenditure from low to middle income countries. This has occurred in part because several countries with a large number of poor people have recently graduated to middle-income status. The Department's policy towards middle income countries is contradictory: it is ending grant aid to India in 2015, but programmes in Nigeria and Pakistan are due to grow rapidly. The Department explains that this is because both countries have a massive share of the remaining MDG burden, yet the same logic applies to India where a different approach is being taken. As expenditure on middle income countries increases, it is even more important that decision-making is rational and consistent; we recommend that the Department establish and make public the criteria it will use to inform decisions of when and how it should cease to provide aid.'

On this topic, it is worth reading the transcript of the evidence of the Permanent Secretary, Mark Lowcock, and the extract in the Select Committee report, as follows:

> 'We need a degree of consistency…, but I do not think we can have a mechanistic formulaic approach to this, because countries are all different and our relationships with countries are different. We do have a view on the kinds of criteria that will be relevant [to when aid ceases]. Progress on the MDGs is one. Growth of the economy is another. The building-up of their own tax base is a third. A fourth one is the country's own preferences and desires. We need to take account of that as well, as, importantly, we did with India. There is a set of things we need to look at, but we cannot be too mechanistic about it and it will be different in each country.'

Consider also that GDP estimates are being revised in many poor countries and that this will affect both the number of poor countries and, depending on the calculation method, the number of poor people. Morten Jerven wrote about this in the Guardian in October 2012, and has now published a book on the subject. In the Guardian, he observed that

> 'Two years ago Ghana's statistical service announced it was revising its GDP estimates upwards by over 60%, suggesting that in the previous estimates about US$13bn worth's of economic activity had been missed. As a result, Ghana was suddenly upgraded from a low to lower-middle-income country . . . Meanwhile, in Nigeria an upward revision is pending. Their base year for the national accounts, 1990, is even more outdated than that of Ghana. According to reports from the National Bureau of Statistics (NBS), Nigeria plans to change its base year to 2008. It has been boldly announced that this could lead to a "huge jump" in GDP figures. This radically challenges our current understanding of economic development in Nigeria and in Africa. According to the World Development Indicators' most recent data, the total GDP in 2010 was above $200bn (in current US$). Nigerian GDP, before the predicted revision, already accounts for 18% of sub-Saharan Africa's total (about $1,200bn). The reports in the media, from the IMF and the NBS all indicate that Nigeria's GDP will increase at least as much as it did in Ghana. Let us be conservative and assume that the GDP in Nigeria merely doubles following the revision. This alone will mean that the GDP for the whole region increases by more than 15%. The value of the increase amounts to nothing less than 40 economies roughly the size of Malawi's. The knowledge that currently there are 40 "Malawis" unaccounted for in the Nigerian economy should raise a few eyebrows.'

There are many different estimates about the likely number of middle income countries in coming years, and also active debates about the definitional boundaries and about whether it is right to provide aid to MICs. However, the politics are inevitably going to militate against aid to MICs. Mark Lowcock did not mention UK domestic opinion in his evidence, but it must have influenced the decision of DFID ministers. Where India goes, how many will follow?

In this connection, it was a mystery in 2012 to the Select Committee, in its Report on Europe) why the DAC list of oda-eligible countries should include Upper Middle Income Countries (UMICs). The list is reproduced below. None of these are on the DFID list of 28 priority countries (though South Africa benefits from regional programmes), but many are on the multilateral list, for example of the EU. At least five DFID countries, by the way, are

already on the LMIC list (Ghana, India, Nigeria, Pakistan, West Bank/Gaza Strip). A number of others are close.

Can remaining aid be spent in Low Income Countries?

If LMICs and UMICs are excluded from development aid (while remaining eligible for humanitarian aid), then more aid will be available for LICs. This is fine, provided that absorptive capacity is not exceeded. What are the chances of that?

The answer depends on how many LICs are available to receive aid and what happens to global levels of aid, both over the next decade or so. These are imponderables about which it is possible to speculate, but a more concrete answer can be found by looking at the

DAC List of ODA Recipients
Effective for reporting on 2012 and 2013 flows

Least Developed Countries	Other Low Income Countries (per capita GNI <= $1 005 in 2010)	Lower Middle Income Countries and Territories (per capita GNI $1 006-$3 975 in 2010)	Upper Middle Income Countries and Territories (per capita GNI $3 976-$12 275 in 2010)
Afghanistan	Kenya	Armenia	Albania
Angola	Korea, Dem. Rep.	Belize	Algeria
Bangladesh	Kyrgyz Rep.	Bolivia	*Anguilla
Benin	Tajikistan	Cameroon	Antigua and Barbuda
Bhutan	Zimbabwe	Cape Verde	Argentina
Burkina Faso		Congo, Rep.	Azerbaijan
Burundi		Côte d'Ivoire	Belarus
Cambodia		Egypt	Bosnia and Herzegovina
Central African Rep.		El Salvador	Botswana
Chad		Fiji	Brazil
Comoros		Georgia	Chile
Congo, Dem. Rep.		Ghana	China
Djibouti		Guatemala	Colombia
Equatorial Guinea		Guyana	Cook Islands
Eritrea		Honduras	Costa Rica
Ethiopia		India	Cuba
Gambia		Indonesia	Dominica
Guinea		Iraq	Dominican Republic
Guinea-Bissau		Kosovo[1]	Ecuador
Haiti		Marshall Islands	Former Yugoslav Republic of Macedonia
Kiribati		Micronesia, Federated States	Gabon
Laos		Moldova	Grenada
Lesotho		Mongolia	Iran
Liberia		Morocco	Jamaica
Madagascar		Nicaragua	Jordan
Malawi		Nigeria	Kazakhstan
Mali		Pakistan	Lebanon
Mauritania		Papua New Guinea	Libya
Mozambique		Paraguay	Malaysia
Myanmar		Philippines	Maldives
Nepal		Sri Lanka	Mauritius
Niger		Swaziland	Mexico
Rwanda		Syria	Montenegro
Samoa		*Tokelau	*Montserrat
São Tomé and Principe		Tonga	Namibia
Senegal		Turkmenistan	Nauru
Sierra Leone		Ukraine	Niue
Solomon Islands		Uzbekistan	Palau
Somalia		Vietnam	Panama
South Sudan		West Bank and Gaza Strip	Peru
Sudan			Serbia
Tanzania			Seychelles
Timor-Leste			South Africa
Togo			*St. Helena
Tuvalu			St. Kitts-Nevis
Uganda			St. Lucia
Vanuatu			St. Vincent and Grenadines
Yemen			Suriname
Zambia			Thailand
			Tunisia
			Turkey
			Uruguay
			Venezuela
			*Wallis and Futuna

*Territory.

(1) This is without prejudice to the status of Kosovo under international law.

situation today. Consider that

- The World Bank database shows only 36 countries currently classified as low income, with a total population of 820m and total GNI of approximately $US 470bn.
- In those countries, about 50% of the population lives on less than $1.25 a day, giving a total number of poor of about 410m.
- According to the latest OECD/DAC Development Cooperation Report, total net oda in 2011 was $US 130bn, of which 57% was Country Programmable Aid (a measure excluding humanitarian aid, aid through NGOs and some other items). ODA amounted to 0.31% of DAC Members' GNI.

On this basis, total oda currently amounts to 28% of the GNI of LICs and to $317 per poor person in LICs. CPA amounts to 16% of LIC GNI and $US 180 per person. If donors were to reach 0.7, these numbers would more than double.

This is an oversimplification. For example, fragile states and least developed countries which are not low income are excluded. Also, it would be impossible to target aid perfectly. Nevertheless, the numbers suggest that there is already more than enough aid to lift all poor people in LICs out of poverty, certainly if the denominator is net oda, and probably also if it is CPA. That would be doubly true if all donors were to reach 0.7.

The more interesting question is about absorptive capacity. Research findings suggest that 'most studies indicate that an 'aid saturation point' could be reached anywhere between 15% and 45% of GDP, beyond which the marginal benefits of additional aid inflows become negative'. In a recent speech, Ivan Lewis, the Shadow Secretary of State for International Development, defined aid dependency as when aid is equivalent to 20% of GNI – and pledged to end it. On this basis, aid to LICs could already be within the saturation range. Even CPA would be close to the upper ceiling if donors reached 0.7.

For some countries, aid dependency is high. The ActionAid Real Aid report, published in 2011, uses CPA as a share of Government expenditure as the metric, and has the following table of aid dependency in 2009, showing numbers up to 200%. The average for all LICs is over 30%.

2009 COUNTRY	%
Afghanistan	199.00
Sierra Leone	92.00
Liberia	88.50
Guinea - Bissau	72.90
Rwanda	65.00
Solomon Islands	64.40
Vanuatu	63.50
Gambia	62.40
Burundi	61.80
Haiti	59.90
Mozambique	58.00
Central African Rep.	56.70
Uganda	55.90
Congo, Dem. Rep.	53.10
Ethiopia	52.50
Tanzania	51.80
Burkina Faso	49.30
Kosovo	45.60
Zambia	43.90
Mali	40.20

Remember, these figures are for today. They do not allow for countries passing the middle income threshold, which many of the 36 are very likely to do in the next few years – especially given current rates of growth in developing countries, and recalculation of GDP.

The conclusion to be drawn is not that aid should be cut today. Rather, the calculation serves to raise some questions about the longer-term landscape legislation would be designed to shape. Bluntly, and heretically, do we actually need 0.7?

Will softening the definition of oda open the floodgates to expenditures of marginal development value?

This is an old chestnut, but one with a new lease of life, as the DAC has agreed to re-open the question of which expenditures are eligible to be counted as oda. Purists feel threatened by the possibility that expensive and marginally developmental items like military spending might be counted as aid, and gobble up, so to speak, the available funds. Their opponents counter that the current definitions are too tight, and exclude legitimate expenditures.

The core definition of oda and the rules about coverage are provided by the DAC and are summarised in a factsheet dated November 2008. In brief, oda is defined as follows:

> 'Official development assistance is defined as those flows to countries and territories on the DAC List of ODA Recipients and to multilateral development institutions which are:
>
> i. provided by official agencies, including state and local governments, or by their executive agencies; and
>
> ii. each transaction of which:
>
> a) is administered with the promotion of the economic development and welfare of developing countries as its main objective; and
>
> b) is concessional in character and conveys a grant element of at least 25 per cent (calculated at a rate of discount of 10 per cent).'

As far as coverage is concerned, DAC members have agreed to limits on oda reporting, for example as in the figure below:

- **Exclusion of military aid** - The supply of military equipment and services, and the forgiveness of debts incurred for military purposes, are not reportable as ODA. On the other hand, additional costs incurred for the use of the donor's military forces to deliver humanitarian aid or perform development services are ODA-eligible.
- **Peacekeeping** - The enforcement aspects of peacekeeping are not reportable as ODA. However, ODA does include the net bilateral costs to donors of carrying out the following activities within UN-administered or UN-approved peace operations: human rights, election monitoring, rehabilitation of demobilised soldiers and of national infrastructure, monitoring and training of administrators, including customs and police officers, advice on economic stabilisation, repatriation and demobilisation of soldiers, weapons disposal and mine removal. (Net bilateral costs means the extra costs of assigning personnel to these activities, net of the costs of stationing them at home, and of any compensation received from the UN.) Similar activities conducted for developmental reasons outside UN peace operations are also reportable as ODA, but not recorded against the peacekeeping code. Activities carried out for non-developmental reasons, e.g. mine clearance to allow military training, are not reportable as ODA.
- **Civil police work** - Expenditure on police training is reportable as ODA, unless the training relates to paramilitary functions such as counter-insurgency work or intelligence gathering on terrorism. The supply of the donor's police services to control civil disobedience is not reportable.
- **Social and cultural programmes** - As with police work, a distinction is drawn between building developing countries' capacity (ODA-eligible) and one-off interventions (not ODA-eligible). Thus, the promotion of museums, libraries, art and music schools, and sports training facilities and venues counts as ODA, whereas sponsoring concert tours or athletes' travel costs does not. Cultural programmes in developing countries whose main purpose is to promote the culture or values of the donor are not reportable as ODA.
- **Assistance to refugees** - Assistance to refugees in developing countries is reportable as ODA. Temporary assistance to refugees from developing countries arriving in donor countries is reportable as ODA during the first 12 months of stay, and all costs associated with eventual repatriation to the developing country of origin are also reportable.
- **Nuclear energy** - The peaceful use of nuclear energy, including construction of nuclear power plants, nuclear safety and the medical use of radioisotopes, is ODA-eligible. Military applications of nuclear energy and nuclear non-proliferation activities are not.
- **Research** - Only research directly and primarily relevant to the problems of developing countries may be counted as ODA. This includes research into tropical diseases and developing crops designed for developing country conditions. The costs may still be counted as ODA if the research is carried out in a developed country.
- **Anti-Terrorism** - Activities combatting terrorism are not reportable as ODA, as they generally target perceived threats to donor, as much as to recipient countries, rather than focusing on the economic and social development of the recipient.

It is too soon to say where the latest round of DAC discussion might lead, but there are pressures both to exclude and include items from the list.

On the exclusion side, aid advocates have long argued that assistance to refugees in developed countries should be excluded from oda. This amounted to nearly $US 4bn in 2010. Other controversial elements (picked up e.g. by ActionAid) include debt relief, tied aid, and technical assistance. Allowing for various other quality adjustments, including

alleged misallocation, they discount as much as 45% of current oda. For their Commitment to Development Index, the Center for Global Development discount debt relief and tied aid, among other things (including misallocation). They discount up to 55% of current flows – in the case of the UK 54% and the EU 58%. Misallocation is probably a step too far for a redefinition of oda (though see above on the country list); and there is a case to be made for technical assistance, which can be valuable. However, there are elements here which deserve careful consideration: assistance to refugees in the home country (which the UK has not claimed), tied aid (which the UK does not use), and debt relief.

On the other side of the fence, the main debate has been about whether to include various categories of military spending (the first three bullets in the figure above). Michael Brozska reviewed this issue in Development Policy review in 2008. He concluded that the cost of 'development-enhancing security expenditure' in 2007 was between $US 33bn and $US 37 bn, excluding US expenditures in Iraq and Afghanistan. That was then equivalent to about a third of oda. However good the case, Brzoska concluded that

> 'there are some valid reasons for including additional security-related expenditures in the ODA guidelines, but with regard to items that would substantially change the amount of ODA, thus affecting political commitments, or where the acceptance is questionable, expansion of the guidelines is not a good idea. Nevertheless, the desire of some OECD DAC member countries for greater recognition of security-related expenditures which, in their view, promote economic development and welfare, is plausible. The challenge is to find a place for them within the OECD DAC reporting system but outside ODA.'

Brzoska recommended that a new category of expenditure should be created, reported to the DAC, but not counted as part of oda. He called this Official Security, Peace and Stability Assistance (OSA).

It remains to be seen whether this sensible advice will be followed.

In addition to these points, there are some arguments to sort out about how to count blended finance, especially that which leverages funding from the private sector. There is also the question of whether the DAC guidelines should set a position with regard to climate finance, discussed in the next section.

Will climate finance swamp traditional aid and distort geographical priorities?

The issue of climate finance has risen up the agenda since the climate talks at Copenhagen in 2009 resulted in commitments to long and short term funding, contained in the Copenhagen Accord. Paragraph 8 of the Accord said that

> 'The collective commitment by developed countries is to provide new and additional resources, including forestry and investments through international institutions,

> approaching USD 30 billion for the period 2010 - 2012 with balanced allocation between adaptation and mitigation. . . . In the context of meaningful mitigation actions and transparency on implementation, developed countries commit to a goal of mobilizing jointly USD 100 billion dollars a year by 2020 to address the needs of developing countries. This funding will come from a wide variety of sources, public and private, bilateral and multilateral, including alternative sources of finance. '

This paragraph generated a great deal of follow-up work, not least by the UN Advisory Group on Climate Change Financing. From the point of view of oda, however, the key questions relate to the words 'new and additional', and to the geographical allocation of climate finance.

In the extreme case, from some perspectives the 'best' case, climate finance would indeed be entirely new and additional, unrelated to current and planned oda levels, and probably separately managed, as an entitlement owing to developing countries rather than a gift. In other words, the poorest developing countries could expect to receive their share of 0.7 from donors, on aid terms, plus a share of $US100bn, on some other terms; and less poor countries, not eligible for oda, would receive a share of the $US100bn.

In practice, this seems very unlikely to happen. In 2010, ODI researchers identified four main definitions, summarised in the Figure below. Only the fourth fully meets the 'best case' test. Option (1) would be worth considering if 0.7 looked like a feasible option. Options (2) and (3) are the most

1. **Climate finance classified as aid, but additional to (over and above) the '0.7%' ODA target:** This definition makes reference to the repeated commitment of the world's governments to commit 0.7% of rich-countries' gross national index (GNI) to official development assistance (ODA). This goal was first pledged in the 1970 UN General Assembly Resolution, which stated, 'Each economically advanced country will progressively increase its official development assistance to the developing countries and will exert its best efforts to reach a minimum net amount of 0.7 per cent of its gross national product … by the middle of the Decade' (UN General Assembly, 1970). This goal has been reaffirmed in many international agreements over the years and, in 2005, individual donors unilaterally pledged to reach the 0.7% target by 2015 (Council of the European Union, 2005). Under this first definition, any finance that goes towards climate change should be in addition to, that is over and above, this 0.7% GNI commitment, which was made in the context of developing countries' needs *before climate change was recognized* and therefore does not factor in the additional finance necessary to address climate change. This definition is supported by Norway and the Netherlands.
2. **Increase on 2009 ODA levels spent on climate actions:** This definition implies that 2009 ODA disbursements on climate change should set the reference level, above which any new ODA finance going to climate change measures can be considered additional. For example, if Country X gave $1 million towards climate change efforts in 2009, and is planning to give $2.5 million in 2010, $1.5 million would be considered additional (subtracting the reference level $1 million from $2.5 million). This definition is supported by Germany.[2]
3. **Rising ODA levels that include climate change finance but where it is limited to a specified percentage:** This definition, supported by the UK's last Prime Minister Gordon Brown, suggests that finance for climate change should be part of traditional aid spending but be limited to a certain portion. Brown specified the following: 'In the UK we will limit such expenditure to up to 10% of our official development assistance' (Brown's speech, 2009). It is recognised that in addition to the 10% of ODA, other (non-ODA) sources of finance will be needed to meet climate change needs.
4. **Increase in climate finance not connected to ODA:** this definition suggests a complete separation between ODA and climate change finance. Under this approach ODA should continue to be used specifically for traditional development activities, and finance for climate change should come from other sources of finance not categorised as ODA.

discussed. Note that Gordon Brown, when Prime Minister, set a policy that would limit climate funding to 10% of UK oda. This has been confirmed by current ministers, and is in fact a level not yet reached. The UK provided £1.5bn ($US 2.4bn) as its contribution to fast start finance 2010-12 (an amount equivalent to 8% of the $US30bn target); and committed £2.9bn for the period 2011-12 to 2014-15, to be disbursed through the [International Climate Fund]. The ICF website confirms that ICF expenditures are to be treated as oda.

Will public sector climate-related expenditures increase or not? Will they continue to be treated as oda? And will they therefore be limited to oda-eligible countries? All these are unanswered questions.

Some back-of-the-envelope calculations to illustrate the range of possible outcomes:

Say that the entire promise on climate funding, of $US 100bn by 2020, is met by the public sector; that the UK provides 8% of the total, as it did for fast start funding (equivalent to about £5.3 bn p.a.); that all the money is oda; that is it funded from within the commitment to 0.7 (£11.3m in 2013-14); and that GNI rises only slowly to 2020 – then up to half the aid budget would be devoted to climate finance.

Or, say that public sector finance was highly leveraged in the $US 100 bn pledge, and that only $US 10-20bn of public sector finance was required; that the UK provided 8%, as before; and that 0.7 is maintained – then only 7-14% of the aid budget would be committed to climate finance.

Obviously, this is a very large range, from 7% to over half. In the former case, climate finance seems easily manageable; in the latter case not.

An additional issue is the geographical distribution. It is likely that a large share of climate financing will go to middle income countries rather than low income countries, if only because they are bigger economies with larger populations and a greater 'entitlement' to adaptation and mitigation finance. If needs are at the lower end of the range suggested above, then few problems are likely to arise. However, expenditure at the higher end of the range would doubtless cause significant problems.

Implications for the future

Three scenarios for the future reflect the challenges outlined in preceding sections. The question then will be about the probability of different scenarios actually occurring, about the appropriate legislative and political response, and about spending arrangements.

In the best case:

- A commitment to 0.7 is maintained;
- This money can be spent on legitimate poverty-reducing ends in mostly poor countries and fragile states;
- Security-related expenses are kept off-budget;
- Climate finance to MICs absorbs only a small part of the budget; and
- There is international agreement on these arrangements.

In the worst case:

- A commitment to 0.7 is hard to sustain;

- Even though budgets are tight, limits to absorptive capacity mean that it is hard to spend the money on legitimate poverty-reducing activities in mostly poor countries;
- Security-related expenses begin to encroach on the budget;
- Climate finance, much of it to MICs, begins to eat up a large share of the aid budget; and
- There is pressure from other donors further to weaken the definitions of both oda and climate finance.

Lying between these two is a third case, which combines elements of both best and worst:

- It is possible to sustain a commitment to 0.7, but only by compromising on what the aid budget is spent on, especially as regards climate change;
- The poorest countries receive what they need, taking account of absorptive capacity, but a good part of the aid programme is spent on climate finance, and perhaps some on security;
- It is accepted that climate finance will go partly (mostly?) to MICs;
- There is international agreement on these arrangements.

The practical issue is that it may be too soon to tell how the geography of poverty will evolve, what kind of climate architecture will be put in place, and how the DAC discussions will conclude. In that case, some flexibility will be required.

First, the 2002 International Development Act specifies that assistance may be provided by the Secretary of State if it is likely to contribute to a reduction of poverty. Thus:

> 'The Secretary of State may provide any person or body with development assistance if he is satisfied that the provision of the assistance is likely to contribute to a reduction in poverty.
>
> (2) In this Act "development assistance" means assistance provided for the purpose of—
>
> (a) furthering sustainable development in one or more countries outside the United Kingdom, or
>
> (b) improving the welfare of the population of one or more such countries.
>
> (3) For the purposes of subsection (2)(a) "sustainable development" includes any development that is, in the opinion of the Secretary of State, prudent having regard to the likelihood of its generating lasting benefits for the population of the country or countries in relation to which it is provided.'

It is interesting to ask whether climate finance or security assistance, especially but not only to MICs, would qualify under this Act. Note there is a 'double-lock': aid must both contribute to poverty reduction and either further sustainable development or improve

welfare. The second part of the lock is so open as to cover almost any spending. The first part, however, is more restrictive.

The 2002 Act refers repeatedly to the 'Secretary of State', and it is interesting that the accompanying explanatory notes were prepared by DFID. Does the Act apply to all oda, or only to that part disbursed by DFID? My sense is the latter, in which case it is worth noting that over 10% of UK oda is spent by other Departments. The details are given in the latest DFID Departmental Report as in the table below: in 2011, £218m was spent each through the Conflict Pool (FCO and MoD) and otherwise by the FCO, £144m by DECC, and £91m by ECGD. If counted as oda, these expenditures are subject to DAC rules. However, are they subject to the 2002 Act?

Table H: DFID and non-DFID Provisional ODA 2011, £ millions

	2011	2010
Total UK ODA	**8,570**	**8,452**
Of which:		
DFID ODA	**7,613**	**7,386**
Non-DFID ODA	**958**	**1,067**
Of which non-DFID Bilateral ODA:	**742**	**885**
CDC Group	59	218
Conflict Pool (FCO & MoD)	218	167
Export Credit Guarantee Department (ECGD)	91	54
Foreign and Commonwealth Office (excluding Conflict Pool)	218	167
Department for Energy and Climate Change	144	255
UK Border Agency (Costs of supporting refugees in the UK)	20	12
Scottish Government	10	9
Gift Aid	65	47
Colonial Pensions	3	3
Other government departments bilateral ODA[1]	36	7
Administrative costs	12	14
Of which non-DFID multilateral ODA[2]:	**216**	**182**
EC Attribution	97	110
Contributions to UN and other multilateral organisations	119	72

[1] Includes the Welsh Assembly; the Department for Culture, Media and Sport; the Department of Health; and the Department for Energy, Food and Rural Affairs.
[2] This consists of core contributions to multilateral organisations from other government departments.

It would be interesting to consider amending the 2002 Act, in order to make sure that all oda is covered, if not already the case. Further amendments would be required to deal with a possible increase of climate funding, and also any changes to the DAC guidelines.

Second, the 2006 International Development (Reporting and Transparency Act) is, as its name implies, mostly about reporting. It refers to 'international aid' (not 'aid disbursed by DFID'), requires reporting on progress towards 0.7, and asks specifically for information about the share of aid spent on low income countries (without indicating a desired level). There is a requirement for reporting on policy coherence, viz non-aid polices (including security and climate?). Because climate change was a nascent issue at the time the Act was drafted, there is little specific mention of climate change or climate funding. It would be

useful to amend the Act in order to include reporting on this issue. The same might be true for security expenses, especially if a separate reporting procedure is established by the DAC.

Third, if there is to be a 0.7 Bill in the UK parliament, it will need to adjudicate on some of the issues here, especially definitions of oda and climate finance.

In all three cases, it might be useful to make reference to the definition of oda, as decided by the DAC or any successor body.

As far as the DAC itself is concerned, the logic of the argument suggests that the country list should be updated. The oda definition could also usefully be tightened, especially to eliminate refugee costs in developed countries and perhaps to revise the terms on which debt relief is treated. It would not seem desirable to change the definition in order to make it easier to include security issues.

The climate finance issue also requires urgent attention in terms of the DAC guidelines. Which of the four definitions of 'new and additional' will the DAC agree? And if some or all of climate finance is to be treated as oda, what are the implications for geographical coverage and uses of oda? Might there be some countries, for example, which qualify for climate oda, but not for poverty oda?

All this also poses a political challenge. Can political parties assume that the status quo will continue, effectively the best-case scenario above? Should they assume another scenario? Or is the best bet to assume uncertainty, plan legislative changes in that context, and deliver a political message accordingly?

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Submission to IDC inquiry into 'The future of UK Development Cooperation'

Tim Jones, Policy Officer
Email: tim@jubileedebtcampaign.org.uk
Phone: +44 (0)20 7324 4725

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1) Introduction

1. This submission focuses on the question of the inquiry as to *"Whether DFID should offer concessional loans, and the balance between these and traditional grant aid."* A substantial amount of UK development aid is already given as loans through contributions to multilateral institutions. Jubilee Debt Campaign calculated that in 2010, $1.26 billion of UK aid money was given to multilateral institutions to then be used as loans. This was the second highest amount of any OECD country, after Japan ($2.23 billion).[1]

2. This submission argues that the UK should not increase aid lending further by giving bilateral loans again, because:

- **There is already a boom in lending to developing countries**

3. Foreign lending to sub-Saharan African governments has more than doubled between 2006 and 2011, and is due to increase even more in 2013. This increase in lending is also seen in very high current account deficits across the continent. Of the 29 countries with DfID bilateral aid programmes, half are already in default on their debts, or the IMF and World Bank judge that there is a high or moderate risk they could be. The other half include countries with rapidly increasing debt burdens, including Ethiopia, Mozambique and Tanzania.

4. A representative of Agence Française de Développement told a meeting of European NGOs in June 2013 that there is currently a glut of cheap loans that the agency is hard pressed to find projects to fund as they are effectively competing with the Germans and the European Investment Bank to find viable projects.

- **There is no mechanism for resolving a debt crisis when it arises**

5. Despite a succession of debt crises on all continents over the last thirty years, there is still no international mechanism for resolving sovereign debt crises. It would be reckless for the UK government to increase lending when there is no effective way to deal with debt problems when they arise. The UK government has consistently opposed the creation of any such mechanism. The UK government should ensure fair, independent and transparent means of resolving debt crises exist before even contemplating increasing debt burdens through more loans.

- **The IMF and World Bank Debt Sustainability Framework does not prevent debt crises from arising**

6. The weakness of the IMF and World Bank Framework include that it pays no attention to the impact of debt burdens on poverty and inequality, it is biased because the Fund and Bank are major lenders and creditors, it fails to take sufficient account of the impact of economic shocks, it pays too little attention to debts owed by the private sector, and it does not assess what lending is used for.

- **The UK government ignores the Debt Sustainability Framework anyway**

7. The current and past UK governments have ignored the Debt Sustainability Framework in their lending decisions. This includes climate loans to Grenada, despite the island being at high risk of debt distress, and non-concessional loans to the Gambia, despite the West African country being at moderate risk of debt distress.

"We will continue, as far as possible, to give aid as grants not loans, and will encourage other donors such as the World Bank to give aid for social objectives, whenever possible, as grants."
A Conservative Agenda for International Development, 2009

"And to avoid another debt crisis hard on the heels of the first, poor countries need to be given more grants, rather than seeing their debt burden piled even higher with yet more loans."
Make Poverty History Manifesto, 2005

2) The theoretical rational for loans and what could go wrong
8. Debt is supposedly good when resources are borrowed now to be invested in something useful which increases how much can be produced. Theoretically this useful investment produces revenue, a part of which can be used to repay the debt, with more left over.

9. However, this theory does not work in practise if:
- The loan resources are not invested in productive enough activities
- The country borrowing the money is hit by economic shocks
- The scale of overall lending and borrowing is too great, or some loans are unproductive, creating too large a debt burden across the whole economy
- Increased revenues do not get passed on to the government through the collection of taxes

10. Research by Léonce Ndikumana and James K. Boyce from the University of Massachusetts finds that, between 1970 and 2008, for every $1 in foreign loans to sub-Saharan Africa, 60 cents left straight away in illicit capital flight.[2] The money was not invested in the country it had been lent to, but the obligation to repay the loan remained.

11. Even if lending is invested in genuinely useful activities, problems can still be created if the project goes wrong, or the country is hit by a sudden change in circumstances. In the early 1980s many governments suddenly had large debts because interest rates increased at the same time as prices for their country's commodities collapsed. A recent IMF and World Bank report states that in one-quarter of cases of what it defines as 'negative economic shocks' in low income countries, foreign owed debt has increased by 20 percentage points of GDP or more.[3]

12. The large level of loans in the 1970s and 1980s, including aid loans, created a debt crisis which affected most of Latin America and Africa through the 1980s, 1990s and into the 2000s, and continues to affect countries such as Jamaica, El Salvador and Pakistan to this day. Between 1980 and 1990 the number of people living in poverty in Latin America increased from 144 million to 211 million.[4] In Africa, the number of people living in extreme poverty (on less than $1.25 a day) increased from 205 million in 1981 to 330 million by 1993.[5] But, the debt was not reduced. Across Latin America and Africa, government foreign owed debt increased from 17 per cent of GDP in 1980 to 33 per cent in 1990.[61]

13. Foreign loans are different from domestic lending and investment because ultimately they can only be used to pay for imports, and the revenue for their repayment has to come from exports. So there are further reasons why external loans can lead to high debt burdens which increase poverty. For foreign loans to be sustainable:
- Loan resources have to be spent on productive imports which do not crowd out local investment

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[1] For further information see Jones, T. (2012). The state of debt: Putting an end to 30 years of crisis. Jubilee Debt Campaign. May 2012.

- The increased production from the loan has to increase exports and/or reduce the need for imports

14. One problem seen across the world is the 'Dutch disease'; first noted for the Netherlands' experience in the 1960s and 1970s. In the late 1950s a large Dutch gas field was discovered. The increased export revenues were spent on imports, pushing up the exchange rate, making manufacturing less competitive, and causing it to decline.

15. The Dutch Disease does not just arise from extractive industries, though this is a very important issue in developing countries. It can also come from official foreign aid and loans, and more generally capital movements. Foreign money, whether loans, equity or grants, can only ultimately be used to buy imports. There is potentially a tension therefore between large amounts of foreign finance undermining the domestic economy. Large inflows, whether loans, equity or grants, can push up the exchange rate, cause more imports to be bought, crowding out domestic production. Just as with natural resources, large foreign capital inflows can undermine a domestic economy. A crisis can be brought on if the money stops being granted or loaned, and/or the finance is rapidly taken out of the country.

16. Whilst grants can contribute to this problem as well, loans are more dangerous because they involve more money - more imports - and so a greater danger of crowding out. And there is a reverse in the resource flow when the loan comes to be repaid, which can help precipitate a balance of payments crisis, especially if local production has been undermined.

3) There is already a boom in lending to developing countries

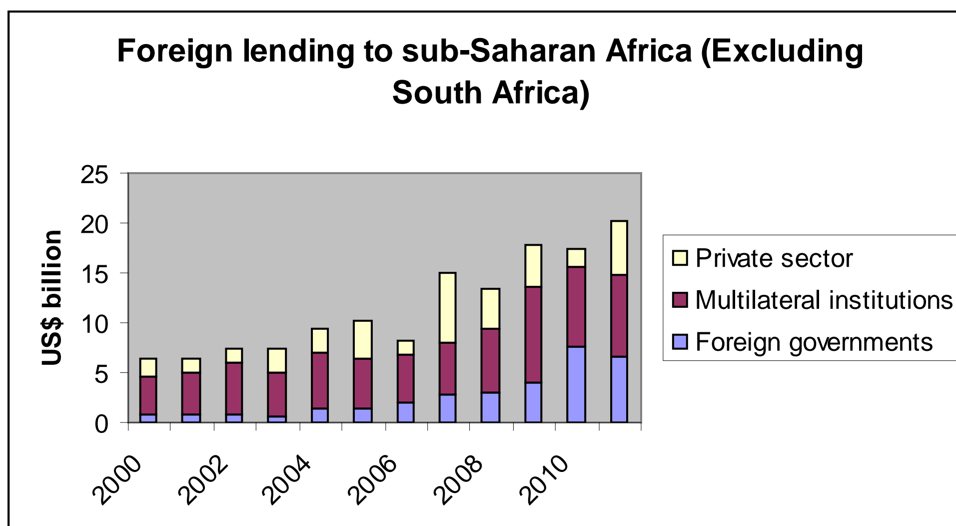
17. Lending to developing countries has been booming in recent years, through a combination of large capital flows out of rich countries during the global financial crisis, increased 'aid' loans from multilateral institutions such as the World Bank and lending from governments as 'aid' or export credits, including traditional actors such as Japan, Germany and France, and new lenders such as China.

18. A representative of Agence Française de Développement told a meeting of European NGOs in June 2013 that there is currently a glut of cheap loans that the agency is hard pressed to find projects to fund as they are effectively competing with the Germans and the European Investment Bank to find viable projects.

19. According to the World Bank, total lending to sub-Saharan Africa governments (excluding South Africa) has increased from $8 billion in 2006 to $20 billion in 2011 (see Graph below).[7] Of this lending:

- 41 per cent is from multilateral institutions, including 25 per cent from the IMF and World Bank
- 32 per cent is from foreign governments
- 27 per cent is from private lenders

20. Furthermore, this boom is set to continue increasing. Just eight sub-Saharan African countries are planning to borrow over $7 billion from foreign private lenders through issuing bonds this year. Governments which plan to borrow through international sovereign bonds in 2013 include Nigeria ($1.5 billion), Kenya ($1 billion), Tanzania ($500 million), Angola ($2 billion), Uganda ($500 million), Mozambique ($500 million), Ghana ($1 billion) and Rwanda ($400 million).[8] In 2011, total private foreign lending to sub-Saharan Africa (excluding South Africa) was $5.5 billion.



21. Another way of measuring the scale of lending and capital inflows is through the current account deficit. This measures all financial transactions by a country which do not create future obligations. If there is a deficit, this can only be met through loans or equity capital inflows. According to the IMF, over the last five years, of 45 sub-Saharan Africa countries:

- 13 have had an average deficit of more than 10 per cent of GDP
- 15 have had an average deficit of more than 5 per cent of GDP
- 9 have had an average deficit between 0 and 5 per cent of GDP
- 8 have had an average surplus

22. Moreover, these deficits are set to stay high, and possibly increase further. IMF predictions for the next five years are that:

- 16 will have an average deficit of more than 10 per cent of GDP
- 12 will have an average deficit of more than 5 per cent of GDP
- 11 will have an average deficit between 0 and 5 per cent of GDP
- 6 will have a surplus[9]

23. In comparison, in the five years leading up to 2008, the UK had a current account deficit averaging 2 per cent of GDP. Greece's was 9 per cent.[10]

Box. Debt situations in DfID priority countries

24. Of the 29 countries in which DfID has a bilateral aid programme:

- Five are in default on their debt payments already, so DfID would presumably not want to lend more money.[11]
- Four are judged by the IMF and World Bank to be at high risk of not being able to pay their debts.[12] It would be extremely reckless for any money to be lent to these countries from DfID's bilateral programme.
- Six are judged by the IMF and World Bank to be at moderate risk of not being able to pay their debts.[13] It would be reckless for more money to be lent to these countries, increasing their debts further.
- Ten are judged by the IMF and World Bank to be at low risk of not being able to pay their debts.[14] This does not mean these countries have low debts, just that the IMF and World Bank judge that at the moment they will keep being paid. For example, the ten countries include:

Bangladesh

25. In 2013 the Bangladesh government's foreign debt payments will be a huge 18 per cent of government revenue,[15] $2.4 billion, the same as the government's

spending on health and 60 per cent more than spending on education. The debt is only payable because the IMF is lending Bangladesh bailout money to be used to repay lenders, with the debt coming to be owed to the IMF.

Ethiopia
26. Ethiopia qualified for some debt cancellation in 2004. Its debt payments fell from averaging 10 per cent of government revenue a year from 1998-2000 to 4 per cent a year from 2007-2009. Combined spending on public health and education increased from 22 per cent of government revenue in 2000-2001 to 32 per cent by 2006-2007.[16]

27. Since the global financial crisis began the government's foreign owed debt has shot-up from $3 billion to $8 billion, and is predicted to reach $18 billion by 2017.[17] In 2012 the IMF predicted that by 2017 the country would be back to spending 10 per cent of government revenue a year on debt payments. This assumes Ethiopia's economy grows by 6.5 per cent a year, and exports by 10-30 per cent a year.[18]

Mozambique
28. Mozambique qualified for debt cancellation in 2001 and 2005. The government's foreign debt fell from 110 per cent of national income at the turn of the millennium, to 60 per cent in 2001, then 30 per cent in 2005. Payments fell from 12 per cent of government revenue in 1998 to a low of 2 per cent in 2007. Public expenditure on health and education increased from 30 per cent of government revenue in 1998-1999 to 36 per cent by 2005-2006.[19]

29. The government's foreign owed debt has now increased to 40 per cent of national income, despite strong economic growth; $6.4 billion. The IMF and World Bank predict based on current lending and borrowing the debt will increase to $12 billion by 2017, by when debt payments will be 9 per cent of government revenue a year. This assumes economic growth of 8 per cent a year and exports of 10 per cent a year.

Tanzania
30. Tanzania qualified for some debt cancellation in 2001 and again in 2005. Government foreign debt payments fell from 9 per cent of government revenue in 2000 to 1 per cent between 2007 and 2011. Government foreign debt fell to 17 per cent of national income by 2007. Despite fast economic growth, it has increased again to 39 per cent of GDP in 2013.

31. Based on current lending, the total foreign owed debt is project to increase from $2.5 billion in 2006 to $12.6 billion in 2013 and $18.4 billion by 2017. Debt payments are predicted to reach 9 per cent of government revenue by 2017, assuming economic growth of 7 per cent a year and export growth of 10 per cent a year.

Other countries
32. The IMF and World Bank only issue debt sustainability assessments for countries eligible to borrow from the IMF's Poverty Reduction and Growth Trust. Therefore, no such assessments exist for the remaining four DfID priority countries: India, Occupied Palestinian Territories, Pakistan and South Africa. Of these, Pakistan is currently in a debt crisis, with government foreign debt payments projected to be over 20 per cent of government revenue this year and next year.[20]

Conclusion
33. Many of the countries at high and medium risk of debt distress are judged in that way not because their debts are especially large, but because their economic weakness means that they are very vulnerable to just one economic shock, which could make it difficult to repay debts. It is too reckless for such countries to be lent

more money; they need grants to assist in economic transformations to make themselves less vulnerable to, for example, changes in international commodity prices.

34. Those countries judged at low risk of debt distress, such as Ethiopia, Mozambique and Tanzania, are assessed in this way because their economies are booming. However, their debts are also increasing, even more rapidly than the size of their economies. This helps shows how foreign lending is still very pro-cyclical, accentuating booms, and possible busts. The UK government should not be adding to this pro-cyclical wave of money.

4) There is no mechanism for resolving a debt crisis when it arises

35. Despite a succession of debt crises across the world for the last thirty years, there is no international mechanism for resolving sovereign debt crises. In the absence of such a mechanism, it would be reckless of the UK to contribute to higher debt burdens.

36. This was recently acknowledged in a paper on sovereign debt restructuring by the IMF. The paper argues that from the recent history of debt crises, such as in Argentina, the Caribbean and Greece, *"debt restructurings have been too little and too late"*. Unsustainable debts get paid for too long, facilitated by IMF loans which bailout the private creditors. When negotiations between the debtor and creditor on reducing the debt finally take place, the amount of debt reduced is too small, continuing the debt crisis. The paper says that this means IMF money is sometimes used *"to simply bail out private creditors"*.[21]

37. Through campaigns such as Jubilee 2000 and Make Poverty History, civil society has advocated for the creation of a fair and independent arbitration system for resolving sovereign debt crises. Government's in debt crisis could join an independent arbitration process. Crucially, the assessments of debt sustainablility would be undertaken independent of creditors and debtors, removing the bias in current bodies which have power to restructure some, but a limited number of debts, such as the Paris Club. And assessments and debt reductions should cover all lenders, not take place in separate negotiations with different groups.

38. However, the UK government has consistently opposed the creation of any such mechanism. The UK government should ensure fair, independent and transparent means of resolving debt crises exist before even contemplating increasing debt burdens through more loans.

5) The IMF and World Bank Debt Sustainability Framework does not prevent debt crises from arising

39. One mechanism which has been proposed to be used to guide lending decisions is the IMF and World Bank Debt Sustainability Framework. However, this has a number of flaws which mean it can miss the build-up of various debt problems, thereby encouraging reckless lending:

- Debt Sustainability Assessments (DSAs) only consider whether or not a debt will become unpayable. The assessments do not take into account the impact of lending and debt levels on poverty and inequality. Furthermore, as other IMF research notes, debts tend to keep being paid for too long (see above).
- DSA's are conducted by the IMF and World Bank, who are themselves major lenders and creditors. This makes the assessments inherently biased. The IMF and World Bank are responsible for 45 per cent of loans to low income countries over the last five years.[22]
- DSAs use 'stress tests' to see what would happen to debt burdens if an economy was hit by *one* economic shock (over a period of 20-30 years). The IMF and World Bank's

own review[23] found that in 12 per cent of cases there have been shocks greater than the *most extreme stress test*.

- The IMF and World Bank have acknowledged that the DSA's do not take enough account of foreign debts owed by the private sector;[24] the kind of debts which have resulted in financial crisis in countries such as Iceland, Ireland, Spain and the UK in recent years, and did so in East Asia in the 1990s.
- DSA's makes little or no analysis of the source of lending and what the lending is being used for.

6) The UK government ignores the Debt Sustainability Framework anyway

40. Since the Debt Sustainability Framework was introduced in the mid-2000s, the UK government has already ignored assessments and lent to already heavily indebted countries.

41. In 2008, the UK government was instrumental in creating the Climate Investment Funds of the World Bank, including the Pilot Programme for Climate Resilience (PPCR). The UK government decided to make a capital contribution of £202 million to the PPCR, so that the expenditure would have less impact on the UK's net public borrowing figures.[25] This decision was taken by the Labour government between 2007 and 2009, and implemented by the Conservative and Liberal Democrat government in 2010 and 2011. Because the contribution was given as a capital grant, it had to be disbursed by the World Bank as loans. Other countries' contributions to the PPCR were given as grants and so used by the World Bank as grants.

42. Recipients of PPCR loans include a $12 million loan to Grenada, which is assessed by the IMF and World Bank as at high risk of debt distress when its loan was agreed, and in March 2013 went into partial default. The UK government has refused to acknowledged that these loans for Grenada clearly breached the debt sustainability framework.

43. Another Caribbean island with an extremely high debt burden is Jamaica, where government foreign debt payments are over 30 per cent of revenue, and the recently signed IMF programme acknowledges that the debt is unsustainable and the country is in need of debt relief.[26] However, as well as not supporting debt relief for Jamaica, the UK government through the PPCR is lending Jamaica money for climate change adaptation. There is no Debt Sustainability Analysis for Jamaica, because it is a middle income country.

44. The UK government also creates debts through UK Export Finance guaranteeing loans for foreign governments and companies to buy partly British made exports. The 2013 annual report reveals that UK Export Finance has guaranteed a non-concessional loan to the Gambian government of £280,000, without any referral to DfID or reference to Gambia's Debt Sustainability Assessment.[27] Since May 2013 The Gambia has been judged by the IMF and World Bank to be at moderate risk of debt distress (before that it was high risk) and that non-concessional loans should only be agreed in exceptional circumstances.[28]

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[5] The percentage increase was from 51.5 per cent of the population to 59.4 per cent. World Bank. Global Development Finance database.
[6] Calculated from World Bank. Global Development Finance database.
[7] Calculated from World Bank. Global Development Finance database.
[8] http://www.iol.co.za/business/business-news/africa-cashes-in-on-foreign-bond-demand-at-lower-rates-1.1511960#.UcBXbefTOSp
[9] Calculated from IMF. World Economic Outlook Database.
[10] Calculated from IMF. World Economic Outlook Database.
[11] Burma, Somalia, Sudan, South Sudan and Zimbabwe
[12] Afghanistan, Democratic Republic of Congo, Tajikistan, Yemen
[13] Ghana, Kyrgyzstan. Malawi, Nepal, Rwanda, Sierra Leone
[14] Bangladesh, Ethiopia, Kenya, Liberia, Mozambique, Nigeria, Tanzania, Uganda, Vietnam, Zambia
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Evidence to the International Development Committee: The Future of UK Development Co-operation

Submitted by: The Center for Global Development (CGD) ***company number FC031146***

9 July 2013

Summary

- The Center for Global Development welcomes the opportunity to submit evidence about **Development Impact Bonds (DIBs)** as a new tool for effective development cooperation in the 21st century.
- The landscape for development cooperation is changing, requiring ways for traditional providers of development assistance to engage new actors and leverage private sector resources.
- DIBs are outcomes-based contracts in which private investors pay in advance for interventions needed to achieve agreed results, service delivery organisations work to deliver outcomes, and donors and/or governments make payments to investors only if the interventions succeed. The model allows each of these actors to make a distinct contribution to the achievement of social outcomes.
- DIBs are a new business model for the delivery of social services in developing countries: they transform neglected social problems into investible opportunities; introduce market rigour to achieving and measuring social outcomes; and build in more flexibility in service delivery than conventional publicly-funded programmes have, allowing for easier adaptation to beneficiaries´ needs and changing circumstances on the ground.
- Donors should consider testing DIBs in a range of areas. In assessing the costs and benefits in any particular case, donors should consider the value of transferring the risk of failure to the private sector.
- An expert Working Group convened by the Center for Global Development and Social Finance has produced a series of recommendations to encourage the development of a market for DIBs including that donor agencies should: *establish a DIB Outcomes Fund; convene and participate in a DIB Community of Practice*; and *promote openness and transparency.*

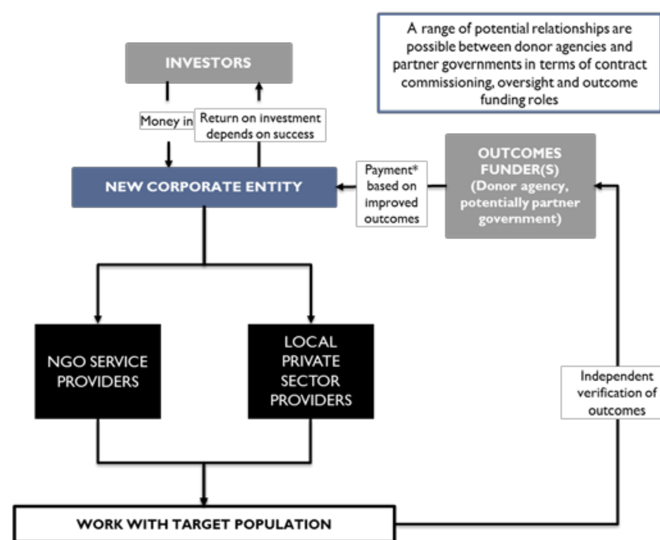
Development Impact Bonds and the Changing Landscape for Development Cooperation

1. The paradigm for development cooperation is changing. The world is no longer divided into rich countries giving aid, and poor countries receiving it. Most of the world's poor live in countries now classified as middle income, and aid flows from new donors such as China and private philanthropy are increasing. The composition of external flows has also changed, with private investment and remittances now much more significant than aid. Meanwhile, an emerging class of social impact investors is seeking investments that yield both social and financial returns in developing country markets. Traditional aid donors are looking for ways to work with these new development actors, many of whom have little interest in the traditional aid model of grants from rich to poor countries.

2. As the context changes, so too does the role of aid. Aid still has an important role to play in supporting the provision of social programmes, but today traditional development agencies are challenged to determine how aid can be used to catalyse and complement the changing composition of financial flows to developing countries. Development cooperation for the 21st century requires new tools that facilitate partnerships between governments and private sector actors who have not just financial resources but skills and expertise to contribute to the achievement of development progress.

3. In this changing environment for development cooperation, Development Impact Bonds (DIBs) have enormous potential as an instrument which brings together the private sector, civil society organisations, governments and donors, in a way that captures and complements the best contributions of each player to achieve social outcomes. In a DIB, public, private and non-profit actors come together and agree on what they want to achieve and a method for measuring success. Typically, but not always, an intermediary organisation will play the role of coordinating these actors: investors, who provide funds to roll out or scale up services; service providers, who work to deliver outcomes; and outcome funders, public sector agencies from developing or donor countries who pay only for results achieved. Government agencies´ contributions to outcome payments are used to pay investors back, and with a premium if the program meets certain outcome benchmarks, so that if interventions successfully achieve outcomes, the returns are social as well as financial. This structure allows each player to make a distinct contribution to the achievement of a desired social outcome more effectively than if it were acting alone.

A Development Impact Bond could be structured as follows:



*Financial returns are commensurate with progress on achieving outcomes

How do Development Impact Bonds work?

4. Development Impact Bonds are not merely a source of finance for development but a whole new business model for the delivery of social services in developing countries.

5. DIBs are an adaptation of Social Impact Bonds (SIBs), an approach pioneered in the UK, with promising experiments underway in America, Australia, Ireland and other countries, designed to provide effective and cost-efficient solutions to social problems through programmes that are more flexible than conventional publicly funded programmes. The first SIB, launched in the UK by the intermediary Social Finance, was designed to reduce recidivism: private investors cover the costs of a range of individually targeted services aimed at preventing reoffending, and are remunerated, with a return, only if evidence shows that those services were successful in bringing down reoffending rates. The UK Ministry of Justice pays returns to investors from the cost savings that result from lower reoffending.

6. Although it is too early to draw conclusions about the success of any SIBs, the Ministry of Justice has released preliminary data that shows that for the target population of this first SIB pilot – ex-offenders from Peterborough Prison – reoffending has gone down by 6%, compared to a national increase of 16%. These early numbers and the anecdotal evidence thus far suggest that service delivery is working well under the Peterborough Prison SIB. Because investor returns are aligned with a social outcome, all actors within the SIB have an incentive to focus on that outcome. This is a change compared to a conventional service delivery model that is based on the tracking of pre-specified inputs and processes. Because under an outcomes-based model public sector agencies are not providing the working capital, programmes have more flexibility, enabling them to adapt to beneficiaries´ needs and changing circumstances on the ground. In the Peterborough Prison SIB, private sector actors are using rigorous performance data to ensure that individual client needs are being met, and are adapting and improving the service delivery model as the programme progresses.

7. An expert Working Group convened by the Center for Global Development and Social Finance explored how the Social Impact Bond model can be applied to developing countries and quickly found that many of the same challenges in public sector service delivery that apply in industrialized countries apply in development as well: social programmes are not adequately focused on achieving and generating clear evidence of outcomes; they are rigidly designed, limiting the learning and adaptation that can take place throughout the processes of delivering services to individuals with often complex needs; and they do not invest adequately in prevention, which often is much less costly than dealing with the treatment of a problem at a later stage.

8. A Development Impact Bond puts in place a business model to deal with these challenges for conventional public sector programmes. The distinguishing feature of a DIB is that because programmes will not typically generate immediate cashable savings, external development

agencies would normally be needed to provide the outcome payment, or some portion of it in partnership with a developing country government, paid only if the results are achieved. DIBs are therefore a tool which can improve both the effectiveness of public services in developing countries and the efficiency of donor spending.

9. By having private investors provide, and assume risk for, funding for social programmes and by tying returns to the achievement of social outcomes, DIBs are a groundbreaking approach to development programmes:
    a. ***DIBs transform neglected social problems into investible opportunities:*** By using concessional public money to put a value on the achievement of social outcomes, DIBs transform seemingly intractable social problems - often involving ensuring access to services for society´s most poor, vulnerable and hard to reach - into "investible" opportunities for investors, who otherwise would not have the incentives to be involved in social service delivery. This widens the opportunities available for investors looking for decent returns but also concerned about social impact.
    b. ***DIBs introduce market rigour to achieving social outcomes*****:** Because investors' returns are tied to the achievement of social outcomes – and because the size of the returns are commensurate with the level of success (i.e. the higher the social gains, the higher the returns) – investors are given incentives to target populations that face the greatest needs, as this is often where the greatest gains (social and financial) are to be had. They are also given incentives to deliver those services in the most efficient and cost-effective way, and put in place the necessary feedback loops or performance management to create bottom-up, client-centred approaches.

What should donors' role be?

10. Under a DIB, it is the role of public sector agencies – typically a donor agency like DFID – to work with Government and other partners to identify the outcomes that society values and ensure that rigorous measurements are taken to determine whether those outcomes have been achieved, and to build an understanding and evidence base of what works under what circumstances in service delivery.

11. DIBs depend on donor agencies being willing and able to provide private sector actors with appropriate risk-adjusted returns. If programmes are not successful in achieving the desired outcomes, DIBs have the benefit of costing taxpayers nothing, as the donor pays only for results. If programmes are successful, they will involve a cost to the taxpayer that is greater than the direct cost of the inputs of the successful programmes, in order to cover a modest return for investors, which helps compensate for the risk of losing their capital. Though successful programmes will appear more expensive for the taxpayer, this is offset by the elimination of payments for unsuccessful programmes. Donors will have to conduct a cost-benefit analysis for the business case of any proposed DIBs, but in doing so should consider the value of transferring

the risk of failure to the private sector, and the comparison of total costs entailed in a DIB with both successful and unsuccessful projects under alternative approaches.

12. Donors should consider DIB cases in a range of sectors and contribute to the development community´s rigorous testing of this new approach. It is expected that a market for DIBs will gradually emerge as the approach is piloted and lessons are shared.

13. DFID could be a leader in progressing the recommendations of the DIB Working Group for donor agencies, including:

    a. ***Collaborate to establish a DIB Outcomes Fund*** to pool risk for initial DIB projects with other donors and to more easily share lessons learned
    b. ***Convene and participate in a DIB Community of Practice*** of donors, investors, intermediaries, government agencies from developing countries and larger service provider organisations, to ensure that learning is shared, disseminated, and applied to future programmes
    c. ***Promote openness and transparency*** to reduce transactions costs over time and help build an evidence base for DIBs; donor agencies should require that outcomes data be made public, and contracts also be published.

Written evidence submitted by Philip Schluter, Managing Director Schluter SA / Schluter Ltd

Background

Schluter is a family business, founded in 1858 and still owned and run by the family. I am now the 6th generation to run the business. Our vision statement is 'To transform lives in Africa through commerce in a mutually profitable way'. I spent my early years in East Africa, and have always had a passion for development in Africa. I studied History and Economics and then Geography at Oxford with a focus on African development. On graduating, I joined the family business, and took over the management in 2003.

Scope of our business

Within the commodity sector in which we operate, we are a small niche player. We work primarily in Ethiopia, Kenya, Tanzania, Burundi, Rwanda, D.R.Congo, Uganda and Cameroon. We have a presence on the ground in several of these countries. We are focused on adding value to the raw product to create a sustainable income stream for small farmers – many of whom rely on coffee as their only source of cash income. I come from the perspective that development is better done through trade than aid. We are representative of the SME sector, and of the challenges they face in raising finance. Most of our suppliers in Africa are in the same position, facing the same challenges in their internal markets.

Views on Development

I am a firm believer that sustainable development is best achieved by promoting income generation in developing countries. Whilst aid can and often does do a lot of good, it can also upset established markets in the commodity sector we operate in, and lead to market anomalies. For example, often well-meaning aid groups can come in and take a small quantity of coffee at a very high price, upsetting the entire local market, and leading to widespread losses as farmers then presume that all their coffee will go at similar prices and hold on to stock which then becomes old/stale and worth much less. Larger aid-backed projects are also well known for setting up alongside private enterprise, and with their overheads paid by grants and consequently lower overheads, they compete unfairly putting the private enterprises out of business. The aid–backed projects then frequently collapse themselves when the aid money is withdrawn or runs out. We have seen this many times in African coffee. This is not to say that some of them have not done some very good work.
Coming from a smaller firm in the sector, access to finance is always an issue, and even more so for the small export companies we work with. They typically need working capital loans of between $10’000-100’000, whereas the available finance tends to be either microfinance of $10 to $100, or large grants of $1million or above. If they are fortunate enough to obtain finance lines through local banks, they are typically at 18-24% p.a. interest, which removes much of their profitability. Many of the countries we work with depend very heavily on coffee as a source of foreign currency (in Burundi it is 80-90%). International pressure has recently led Burundi to auction off their internal coffee infrastructure, with the main buyers being multinationals, which in our opinion is very counter-productive. We believe that supporting locally owned export companies through partnerships allows the value added to remain 'in-country' and builds prosperity in the local economy. However, the main barrier to this is access to finance, with proper understanding of futures markets and risk management being the other main barrier to local operators succeeding.

What is needed most

Hence, from our perspective, the greatest need is to make finance available to smaller companies to fill the gap between microfinance institutions and the larger loans, which are typically taken up by the multinationals. There are some institutions beginning to fill this space, but there is still a large gap. Equity investments, with some risk-sharing would also be very welcome. Typically the places most in need of development are also those with the highest risks. I am aware that management of finance is costly, hence the propensity to lend larger amounts, but perhaps funds could be used

either to pay internal staff to manage a multitude of smaller projects, or to outsource this management with a reporting system which ensures that the finance fulfils the criteria set out for it. The finance available within this space currently carries a relatively high interest rate due to the costs of managing the loans. Lending in smaller tranches at reasonable interest rates could have a major impact on the local economies we are working with.

Although I studied development theory in my bachelor's degree some 20 years ago, my experience remains quite narrow – within coffee and Africa, and thus questions which reflect this will obviously be easier to answer.

I hope that this gives some guidance as to the perspective I am coming from

August 2013

Written Evidence submitted by Caroline Ashley[1], on
Engagement with the Private Sector, Development Finance and Other Instruments.

International Development Committee: The Future of UK Development Cooperation

1. Given the Committee's interest in how UK development cooperation can engage effectively with the private sector in developing countries, this submission draws on practical experience in a range of development initiatives – including challenge funds – that directly collaborate with the private sector in Africa and Asia and seeks to provide a view from the ground.[2]

2. The first section considers different reasons for engaging with the private sector and what instruments may be appropriate. The second section considers institutional implications of private sector engagement.

3. The main conclusions are that concessional finance for private sector growth are one possible instrument and one possible objective, but others should not be ignored. There is much that donors can do to support a 'better' private sector not just a 'bigger' private sector by carefully applying public funds – and DFID is already active in this emerging space. Though finance is needed, a range of instruments are useful.

4. Whichever objective and instrument are selected, there are organisational and operational challenges for a donor organisation engaging with the private sector. These are not insignificant.

Unpacking Assumptions about Objectives and Instruments

5. Discussion of private sector engagement from a development perspective can be plagued by three generalisations: there is a tendency to speak of 'the private sector' as a monolith (rather like 'the poor'); an assumption that the obvious donor instrument is finance; and an assumption that the best measure of success is jobs. I would suggest that all three generalisations require scrutiny and nuance.

Unpacking the 'private sector'

6. Poor people engage with many types of private company in many different ways., from being smallscale private sector actors themselves (farmers, traders), to buying brands that they trust (for their soap or seeds) or shoddy goods that are all they can afford, and seeking employment in local firms or distant factories. Their private sector engagement is far from perfect. Many lack income and access to employment. Their own informal sector activities are constrained by shallow or distorted markets. They lack access to affordable quality goods. Medicines, water and energy are often purchased privately rather than provided publically at disproportionately high cost for low quality.

7. The implication is that there are many ways in which 'private sector development' can influence livelihoods of the poor. For example

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[1] Director, Ashley Insight Ltd

[2] Current work as Results Director of the Business Innovation Facility covers engagement with over 100 companies in Africa and Asia. A similar role in Sida's Innovations Against Poverty reaches another 50. I also lead on results for the new DFID IMPACT programme, supporting impact investment. Previous work since the nineties, included work with the tourism sector and on wider issues of private sector in development. I have never worked within DFID but much of this has been in collaboration, funded or commissioned by, DFID.

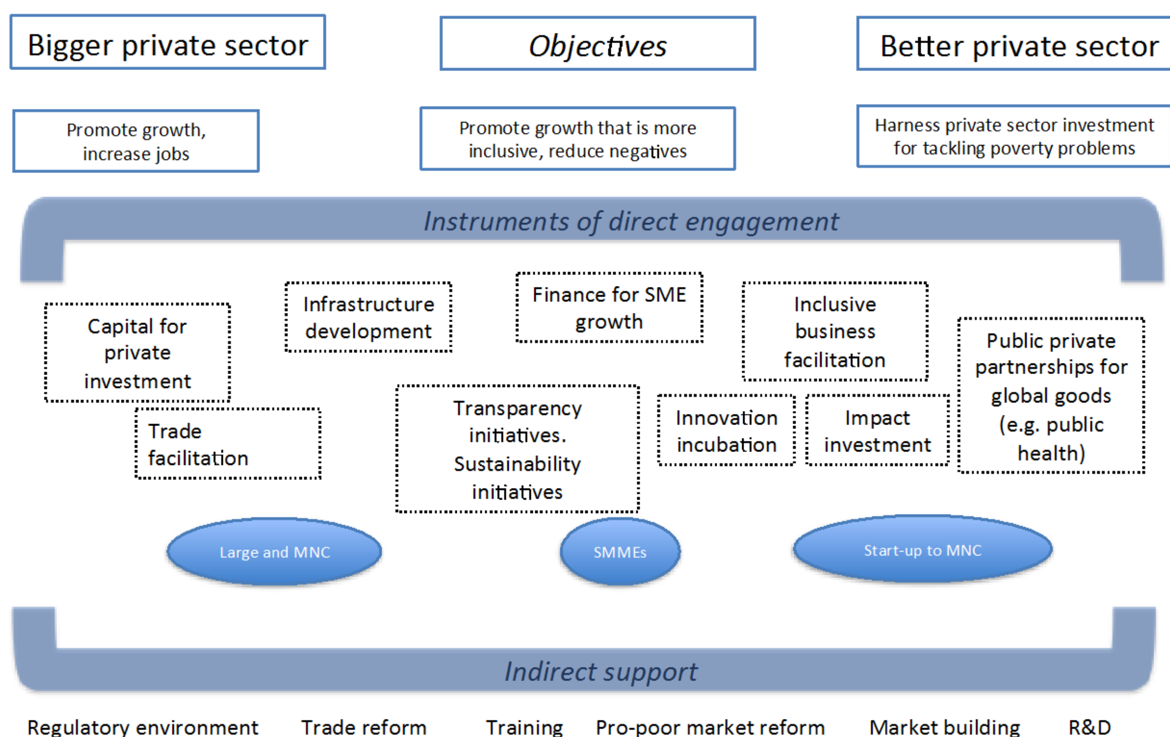
- Business investing in goods and services appropriate to low-income consumers can boost access and affordability of livelihood essentials.
- Improving the trading environment can enable informal sector workers and entrepreneurs to achieve efficiency gains
- Expanding business activity can boost access to jobs, or to markets for their produce.

Therefore there can be a number of different development objectives for a donor engaging with the private sector.

Unpacking objectives and instruments of private sector engagement

8. Broadly speaking, objectives of private sector engagement lie on a continuum, illustrated in Figure 1. At one end, 'bigger': expansion of the private sector, via investment, to achieve faster growth, and ergo jobs. At the other end, 'better': changing how companies work, so growth is more inclusive and solutions to poverty get innovated and scaled. The former is generally familiar. The latter may be less so but includes:
   - Public private collaboration on public goods, such as nutrition, vaccines, carbon emission reduction.
   - Facilitation of 'inclusive business' models, which generate both commercial return and direct gains for low-income people as producers, entrepreneurs, employees or consumers.
   - Impact Investment, which seeks investments that generate both commercial and social return.

Figure 1: A spectrum of development objectives and variety of instruments for private sector engagement



9. Intervention at any part of the spectrum can have catalytic affects: first round success leads to further investment or innovation by others and changes in how markets work.

10. This analysis is important because it is too often assumed engagement with the private sector is just about jobs and growth. It's not. It varies. Clarity of objective helps ensure the right instrument and indicators are chosen.

11. This sounds totally obvious, but its remarkable how often I am asked about the number of jobs created by companies supported by the Business Innovation Facility (BIF). Funded by DFID, the Facility has spent around $4mn on support to companies developing 'inclusive business'. They are developing mobile trading or soil testing kits for farmers, quality education for rural schoolchildren, clean toilets in slums, gas stoves affordable by the poor, and much more. Direct job creation is meagre, but also misses the point.

Selecting instruments for private sector engagement:

12. Where 'bigger' is the main objective of private sector engagement, finance for investment is one obvious instrument. Others include building infrastructure, banking systems, legal systems, and unblocking physical or regulatory impediments to trade. Finance on its own is insufficient.

13. Where 'better' is the main objective – and is the main focus of my work – finance can again play a role, but tailor-made tools are needed. Catalysing business growth that is pro-poor requires risk-sharing, technical assistance, policy engagement, partnership brokering, market building, cross-fertilisation, sector-specific engagement and patient finance.

14. There is evidence that more and more companies are embarking on business initiatives that can be described as inclusive business, creating shared value, or contributing to public goods. They do so for long-term strategic commercial reasons. But the returns are slow and the process is painstaking. Given positive externalities, risks and uncertainty, there is clear scope for application of public funds for development objectives.

15. The value of technical assistance has been highlighted by the experience of the Business Innovation Facility. BIF supports individual companies directly, but with technical assistance not money. Approximately 50 companies have each been supported with around £50,000 of DFID-funded technical assistance (TA) and as many again received shorter term support. The TA is targeted at helping an 'inclusive business' build a sustainable business model. Feedback from companies suggests that:

    - The pool of companies that see the immediate need for technical support is smaller than the pool of companies that seek grants;

    - But the value of TA when timely and targeted is high: it can help entrepreneurs build a more robust business model, avoid mistakes, be more attuned to the needs of the poor, deliver proof of concept for internal financing, or get the business investment-ready. Short one-off inputs can have long-term affects.

    - TA that comes from a donor-programme has added value, because of the credibility it brings, which in turn helps open other doors.

16. Other organisations increasingly provide TA alongside finance. DFID is unusual however, in having a facility that offers only TA in this field.

17. However, the shortage of finance is not resolved by TA, and is undeniable. Many companies supported by BIF reach the need for expansion or working capital but despair of local banks and traditional investors. Take the example of Furniture Village in Nigeria: an innovative proposal for a cluster of artisanal furniture makers and a furniture store, developed by a leading business woman in Nigeria. The CEO herself sits on boards of many banks in Nigeria, so the fact that she could not raise finance within Nigeria for Furniture Village is clear testament to the fact that domestic finance is not ready for the risks and innovation of inclusive business.

18. There is high demand for finance that is targeted at inclusive business. Many of the companies supported by the Business Innovation Facility and Innovations Against Poverty report problems in accessing the right kind of finance. At the African Enterprise Challenge Fund, no more than one in ten proposals secure funding (grant or loan). Earlier this year, CDC ran a Request for Proposals for the new Impact Fund, funded by DFID. Open to funds operating in Africa and Asia, applications topped 120, with 80 focusing on Africa.

19. These example highlight demand for impact investment where investors are willing to take a slower or lower financial return because social value is created. There is some debate, however, whether the biggest gap is in supply or demand. While entrepreneurs bemoan lack of finance, it is common wisdom amongst impact investors that a lack of investible propositions is a major constraint. Both perceptions have validity. The market simply does not work well yet – they cannot find each other. And what is offered and needed are not quite the same: early stage funding, to help companies be ready for larger inputs, is scarce.

Implications and institutional issues for donors engaging with the private sector

Comparative advantage

20. DFID has been ‘ahead’ on Private Sector engagement and particularly on inclusive business and impact investment, compared to other donors. It is seen as willing to engage, take risks, try new approaches. Staff have been creative and adaptive. DFID is adding value and has a comparative advantage on which to build.

21. DFID is already investing and testing in impact investment. While the amount may be small relative to the mainstream, it still represents a major change over the past year. The impact investment market is evolving quickly but few other donors or DFIs are so focused on it.

22. Several other donors have development banks. Relatively few specialise in impact investment. While some DFIs would argue that everything they do can be defined as ‘impact investment’ I would disagree. Indeed, preliminary indications from the IMPACT programme are that there is a clear difference between the objectives of IMPACT and objectives of a more traditional DFI. The social return is much more important for most impact investors. From the first months of IMPACT, I would also observe that the impact investment approach is also quite different to standard practice for CDC.

23. A small but growing minority of other donors are now active in inclusive business or variations on the theme: GIZ, IFC, Sida, JICA, USAID, AusAID. DFID, which started with challenge funds over a decade ago, has already reached the post-hype stage, has a range of programmes completed or operational, and would be well set for a proper state-of-art review to for designing the next generation of support.

24. DFID is good at piloting in general and in this space. Arguably performance is more variable on applying staying power to build on lessons and scale what works. The areas of inclusive business and impact investment are both rich seams with more results to be reaped.

Internal or external management?

25. The Committee is interested in whether development finance is best run inside DFID or externally. While I cannot comment on that, I have observed the 'clash of cultures' between public and private sector and the advantages of out-sourcing direct private sector support to an external firm (BIF is managed by PwC, the Impact Programme is run by CDC and PwC):
    - Finalising contracts can become a vast task engrossing legal departments. Typical clauses in DFID contracts (such as on Intellectual Property Rights) have been known to kill off an emerging engagement.
    - Due diligence can be another vast task, run-of-the-mill for banks and auditors, but probably much tougher in a civil service setting.
    - Culture is hard to define, but differs: accountability is critical in the civil service, whereas an investor may give a company its decision to invest on the same day. Both DFID and companies are used to being treated as 'clients,' but clients expect others to fit into their pace, not vice versa.

    Whatever mechanism is used, combining development and private sector expertise is critical, and can be highly productive.

Challenges and risks

26. The biggest 'misfit' between DFID's procedures and the necessities of private sector engagement is programmatic duration. To truly achieve and measure development impacts from private sector support, a minimum of 6 years is needed; 10 is ideal. A best guess is that an innovative inclusive business takes 2-3 years of iteration, 3-5 years to operate and then scale, and sometimes longer. Most DFID programmes simply do not last that long. There are welcome departures however: the Impact Programme – where funds are committed via CDC - is planned for 13 years, and M&E will continue throughout.

27. A corollorary of this misfit is that monitoring and evaluation (M&E) is important but may be slow to yield results. I am told that PIDGE provides a good example: after the first 2-3 years, most of the companies looked like failures. Fortunately this is another welcome example where DFID are taking a longer time-frame. The implication is that pressure for good M&E is helpful; pressure for quick M&E evidence is not. M&E that is not just project- based, but reviews all DFID engagement with the private sector is probably needed to generate true evidence of value. Ex post M&E still seems to be rare in this space but is definitely needed.

28. There are donor risks from private sector engagement. Reputational risk is the most obvious: a company culprit is revealed to have DFID support. This risk can be reduced but not removed.

29. Two more common risks are:

    - Risk of business failure. If public subsidy is used to buy down risk of an investment which the commercial market won't support, there is self-evidently a risk of business failure. 100% success would suggest public subsidy is not best used. But tolerance of 'failure' needs to be explicitly built into metrics.
    - A more subtle risk is that when a donor engages with a company it is not in control. The logic of the intervention relies on business success, which requires rapid adaptation to challenge or opportunity. The means used will vary from the initial plans agreed. I have seen other donors truly struggle with this. What matters is that the development gain (whether defined as jobs, ports, innovation, or clean water for the poor) are achieved. But being clear on ends and flexible on means can be challenging.

30. The implications is that two things are needed:
    - willingness to take risks. Again this sounds obvious but it depends on institutional structure. There is some concern that a DFID culture in which process and results are increasingly emphasised may inhibit ability to take risks.
    - careful management of expectations (of leaders and commentators), clear logic and strong M&E.

31. 'Hype' is itself a problem in this space. Private sector engagement and inclusive business have both suffered in recent years. Hype feeds the critics: straw men are easily built up and knocked down, when the hype is not sufficiently nuanced about the good bad and limitations of private sector in development.

32. Public perception and mis-perception is a challenge for donor engagement with the private sector. There is no easy solution, but it will have to be tackled if this becomes a more major plank of development cooperation. Four suggestions:

- Clarity of objectives: that the private sector is not an end in itself, but a means to a raft of important development goals.

- Clarity of logic, particularly around the role of profit: usually the logic chain for development via the private sector involves profit (not CSR). For example, DFID supports companies that are innovating commercial solutions in clean water and energy that meet the needs of the poor. The logic is that a solution that is both profitable and pro-poor will go to scale at much less cost than a subsidy-driven solution. Profit is not an unfortunate side affect, it is crucial to reaching scale. Clarity of logic is the first – though admittedly not the last – defence against simplistic critiques.

- Recognising limitations. There are many development goals that are not well-achieved via private sector engagement. In BIF and other programmes we are finding that business can reach down to the next layer of the economic pyramid – those below the middle class – and transform their access or opportunities. But they are very unlikely to reach the poorest layers, for whom other measures remain critical.

- Willingness to tackle the negative aspects of private sector activities in developing countries, while supporting the positives. A vast agenda, which should not be ignored.

Building on Innovation

33. DFID is an innovator in this space. This lays a strong basis for further building private sector engagement into revised cooperation plans, and for continued innovation. My recommendation would be not just to put large amounts of money through concessional finance, but to keep innovating and shaping. The recommendation for innovation however comes with two caveats:
    - Innovation for the sake of it, or repackaging for new political news, should be avoided. Businesses get wary of new announcements.
    - Innovation is a management and cultural issue. What applies to companies can apply to DFID too: innovation needs to be cultivated and built upon. This requires space to test approaches, pressure not to deliver quickly but to deliver lessons on what to scale up and why. Innovation management' is both an art and science these days. While DFID is supporting innovation externally, it will also need to cultivate it internally. Building an institutional structure that cultivates innovation is difficult, in both private and public sectors.

CONCLUSION

Engagement with the private sector is likely to be an ever-increasing part of future development cooperation. There are good reasons for this as a number of development objectives (though certainly not all) can be achieved through the private sector. However, to maximise development impact and build on DFID's comparative advantage, it is important to consider approaches that promote 'better' not just 'bigger' business. New business models are emerging that directly benefit low-income people but need public support. Finance, particularly impact investment, is needed, but is insufficient on its own.

DFID is already an innovator in a range of tools, including technical assistance, that harness private sector contributions for development, and continued innovation is important. Expanding this work will mean taking on board the various risks and challenges of private sector engagement, being extremely clear on the logic, pros and cons of this work.

29 August 2013