4

Scaling Up Aid to Poor Countries

The global financial crisis is impacting an increasing number of developing countries. Low-income countries, which had previously been relatively shielded from the immediate effects of the crisis, are now particularly vulnerable. They are facing shrinking export markets, sharply lower commodity prices, and declining growth rates. The global crisis has raised the risk of poverty and hardship for households in poor countries—about 40 percent of developing countries are highly exposed to the poverty effects of the crisis, and a majority of them are in Sub-Saharan Africa. At the same time, the weakening of economic activity is depressing fiscal revenues in these countries, even as social, infrastructure, and other public spending needs are rising. More than half of low-income countries could see a decline in revenue-to-GDP ratios in 2009. But most low-income country governments will not be able to make up the shortfall in their budgets by borrowing domestically or internationally. The increased fiscal pressures are placing the delivery of basic services at risk and constraining these countries' ability to undertake countercyclical spending.

Without additional external assistance, the impact on poor countries could be severe. Donors have a key role to play in helping low-income countries to protect hard-won gains on the Millennium Development Goals (MDGs) through support of social safety nets and key development programs. However, concerns are growing that aid could be cut, precisely when an increase is sorely needed. Aid budgets are beginning to come under pressure as advanced economies implement large stimulus packages in response to the deepening global crisis. Donors must resist such pressures and deliver on aid commitments. But meeting existing commitments may not be enough. Indeed, there is a strong case for going beyond those commitments in view of the increased needs of countries hit hard by the crisis.

The Vulnerability Fund proposed by World Bank President Robert Zoellick is a mechanism that can be used to channel additional support. The fund, which would require developed countries to pledge 0.7 percent of their stimulus packages for developing countries, would assist vulnerable countries to protect critical spending.[1] By supporting growth in developing countries, the additional aid effort would be an investment in global economic recovery.

In light of the current global downturn, the need to make development assistance work better—predictable and timely aid that is aligned with country priorities and focused on results—has taken on added urgency. At the High-Level Forum on Aid Effectiveness held in Accra, donors and partner countries recognized the need to implement more reforms at a faster pace to meet the 2010 Paris Declaration targets. Within the context of a changing aid landscape, forum participants also sought to enhance aid effectiveness by acknowledging the need to embrace all development actors—bilateral, multilateral, private sector, global funds, and civil society organizations. Moving forward, the challenge will be to convert promises and intentions into actions.

Aid from private actors, particularly foundations and businesses, has grown rapidly in recent years, although there is some concern that the current crisis may interrupt this trend. Private participation brings new resources and innovative approaches to address pressing development problems. The size and impact of private donors' activities are influencing the aid agenda in profound ways. Public-private partnerships in aid programs are growing for key global priorities such as health, education, and climate change. As the role of private actors in the development arena expands, so does the need for improved aid coordination and alignment.

The Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI) have substantially lowered the debt burdens of poor countries, but the current crisis could jeopardize gains in debt sustainability. Debt reduction combined with improved policies had created fiscal space to increase poverty-reducing spending in many HIPCs. Some countries may have scope for undertaking appropriate fiscal stimulus to cushion the impact of the global crisis, but many others are constrained by debt sustainability or resource availability. Creditors and borrowers need to ensure that new financing is on appropriate terms to maintain long-term debt and fiscal sustainability.

Rising Needs, Uncertain Aid Prospects

From the food and fuel crises to the financial crisis, global challenges are placing an extraordinary strain on poor countries. On the one hand, these crises are exposing households to the increased risk of poverty and hardship, especially where initial poverty levels are high. On the other, they are adversely impacting budgetary positions. Low-income countries, especially in Sub-Saharan Africa, are particularly vulnerable. Additional development assistance is essential to lessen the impact on these countries. But prospects for higher aid are uncertain amid heightened fiscal pressures in donor countries. Indeed, there is a risk that aid flows could decline.

Low-income Countries' Needs Are Increasing

Food crisis. The sharp rise in food prices between 2005 and 2008 pushed an estimated 160 million to 200 million more people into extreme poverty. Although food prices have since moderated, and some of the poverty effects have been reversed, the underlying problem of a sustainable global food supply persists.[2] The Comprehensive Framework for Action, which draws upon the World Bank's New Deal on Global Food Policy, represents a coordinated response to address the global food crisis.[3] It combines immediate actions to increase food availability to meet the needs of vulnerable populations with steps to strengthen food security in the longer run by addressing the underlying factors driving the food crisis. Preliminary estimates of the global incremental requirement for improving food security range from $25 billion to $40 billion a year. The High-Level Task Force on the Global Food Crisis has urged donors to double food assistance and to raise the share of agriculture in official development assistance (ODA) from 3 percent to 10 percent within five years.[4] It is important that the increase in resources for agriculture represent additional financing and not a diversion of funds from other sectors. Equally important, the resources should be provided in a predictable and flexible way.

Financial crisis. Following on the heels of the food crisis, the global financial crisis is straining countries even further. As the impact of the global slowdown on low-income countries intensifies in 2009, fiscal positions (already weakened by events in 2008) in these countries will come under increasing stress. The International Monetary Fund (IMF) estimates that about a quarter of low-income countries will face a fall in revenue of more than 2 percentage points of GDP in 2009.[5] Preliminary findings by the World Bank show that only 13 percent of low-income countries for which data are available will run a budget surplus in 2009 (compared with 28 percent in 2008 and 34 percent in 2007).[6] Countries in Sub-Saharan Africa and Europe and Central Asia are facing an especially large deterioration in their budget balances: budget deficits as a share of GDP are expected to rise on average by 4.7 percentage points in Africa and by 2 percentage points in Europe and Central Asia.

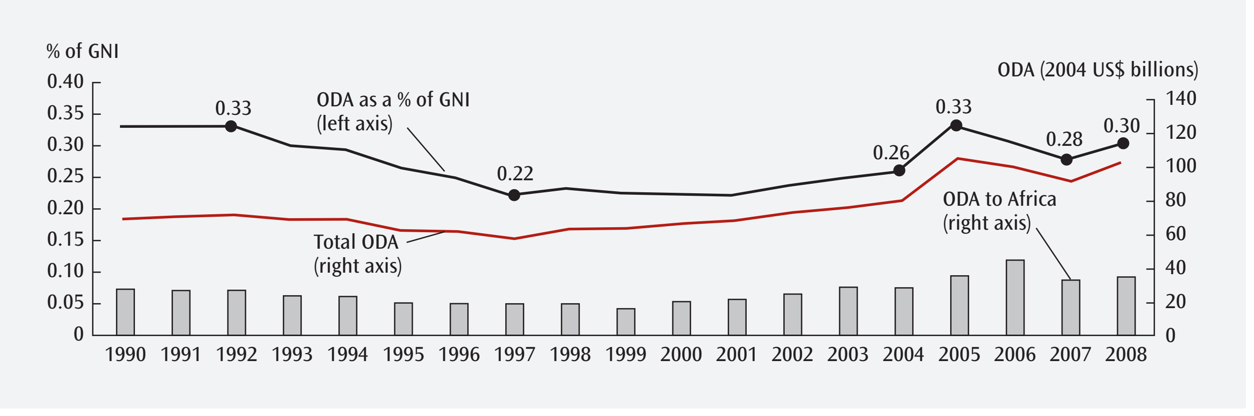
Under current crisis conditions, most low-income countries have little maneuvering room to secure more borrowing or raise revenues. Even countries that have the macroeconomic space and administrative capacity to support higher fiscal deficits will have difficulty securing financing.[7] This limited fiscal capacity will constrain poor countries' ability to maintain basic services, let alone undertake countercyclical increases in spending. Without increased assistance, millions more could face malnourishment and slip into poverty. Investment in infrastructure and productive sectors will also be hit, threatening long-term growth prospects and progress on the MDGs.

The likely fiscal impact of the crisis on poor countries makes it all the more urgent to increase development assistance, including delivering on past aid commitments and responding to the additional needs arising from the crisis. For many poor countries, timely availability of increased assistance will be key in enabling them to protect essential social safety nets and support development programs critical for growth.

There Are Large Gaps between Aid Commitments and Delivery

Recent ODA trends show a wide implementation gap. Progress on aid volumes has been mixed in recent years. Preliminary estimates show that net ODA from Development Assistance Committee (DAC) members moved sharply higher in 2008 to $119.8 billion, an increase of 10.2 percent in real terms (figure 4.1). The uptick in ODA followed two years of declining aid, as official debt relief operations returned to more normal

FIGURE 4.1 DAC members' net ODA 1990–2008



Source: OECD database.
Note: 2008 data are preliminary.

levels in 2006–07. The expansion in ODA boosted donors' ODA share in gross national income (GNI) from 0.28 percent in 2007 to 0.30 percent in 2008, but the share remains below the 0.33 percent level reached in 2005. At Gleneagles, and subsequent summits at Heiligendamm and Hokkaido, G-8 donors promised, with other donors, to double aid to Africa by 2010—an increase of $25 billion a year compared to 2004 amounts—and to increase overall aid by $50 billion a year by 2010. Measured against these pledges, net ODA would need to increase by $29 billion in 2004 terms by 2010. Some existing ODA commitments expressed as a share of GNI could be devalued by falls in expected GNI—consequently, the DAC estimates that the needed increase could be about $20 billion by 2010. ODA trends point to a continuing shortfall on aid commitments.[8]

With debt relief reverting to levels of the early 2000s, the pace of ODA growth will depend upon the expansion of other aid categories. Key among these will be country programmable aid (CPA), which includes program and project aid and technical assistance.[9] But this component of aid has shown only a modest increase in real terms, rising at an average rate of 4 percent per year since 2004. Substantial annual increases in CPA will be needed in 2009–10 to meet the 2010 aid targets. Two years before 2010, the prospects of reaching these targets are uncertain.

Mixed progress on ODA to Sub-Saharan Africa. Donors have made substantial commitments of assistance to Africa, but scaling up of aid to the region has been uneven. Net ODA flows to Sub-Saharan Africa rose from $26 billion to $40 billion during 2004–06, but fell back to $34 billion in 2007. Excluding debt relief, development assistance rose from $22 billion in 2004 to $31 billion in 2007. Country programmable aid grew at a more moderate pace, rising from $19 billion in 2004 to about $23 billion in 2008. Preliminary data show that net bilateral ODA from DAC donors to Sub-Saharan Africa was relatively unchanged in real terms in 2008 at $22.5 billion. But excluding debt relief, bilateral aid to the region was up by 10 percent. However, only one-third of DAC members have made substantial progress in scaling up aid to the region—that is, achieving a 50 percent or larger increase in their assistance to Sub-Saharan Africa. Most donors, including some large ones, are lagging in scaling up aid to the region. Significant growth in aid—25 percent per year—will be needed in 2009–10 to meet donor commitments to provide an additional $25 billion per year in aid to Africa by 2010.

Amid large infrastructure gaps in African countries, donors are beginning to step up support for infrastructure investment in the region.[10] The bulk (nearly 70 percent) of bilateral ODA to Sub-Saharan Africa is allocated to social sectors, and the share of infrastructure is modest at about 10 percent.[11] But a shift toward infrastructure spending appears to be under way, as key bilateral and multilateral donors increase infrastructure commitments under the aegis of the Infrastructure Consortium for Africa.[12] During 2005–07, consortium members increased concessional and nonconcessional infrastructure commitments to Africa by over 75 percent, to $12.4 billion—bilateral ODA increased from $2.2 billion to $3.5 billion and multilateral ODA rose from $2.9 billion to $5.9 billion (figure 4.2). Non-DAC donors such as China and India are playing an expanding role as well, particularly in the energy and infrastructure sectors. Donors' increased focus on infrastructure is welcome, but it is important that this shift not reduce the amount of resources available for much-needed spending on health and education.

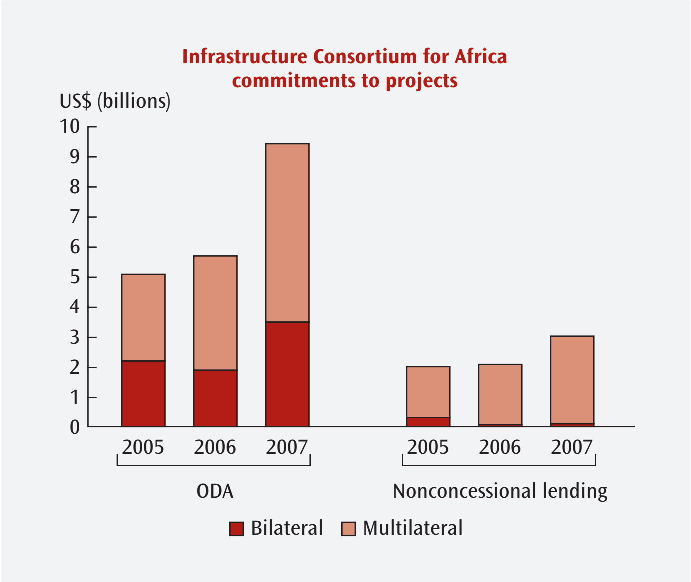
Planned scaling-up falls short of targets. A perspective on future aid flows is available from the latest DAC Survey on Aid Allocation Policies and Indicative Forward Spending. The survey shows planned CPA flows, including which countries and regions are likely to receive more aid, and helps to assess whether aid targets are on track globally and for Africa.[13] The response rate to the

2009 survey was 85 percent; some donors have yet to provide indicative forward aid plans.[14] Preliminary survey findings suggest a nearly $30 billion shortfall in the CPA needed to meet the 2010 targeted increase in total net ODA (figure 4.3).[15] CPA will need to rise substantially more than planned if aid targets are to be met.

What do the forward spending plans imply for aid to Africa? Although planned scaling-up is largest for Sub-Saharan Africa, programmed increases fall far short of the required amounts for meeting aid targets for Africa. CPA to Africa increased by $6 billion from 2004 to 2008, and an additional $3 billion is planned during 2009–10. Assuming that debt relief and humanitarian assistance remain at their long-term levels, CPA to Africa would need to rise by about $17 billion for donors to meet the 2010 aid targets for the region.

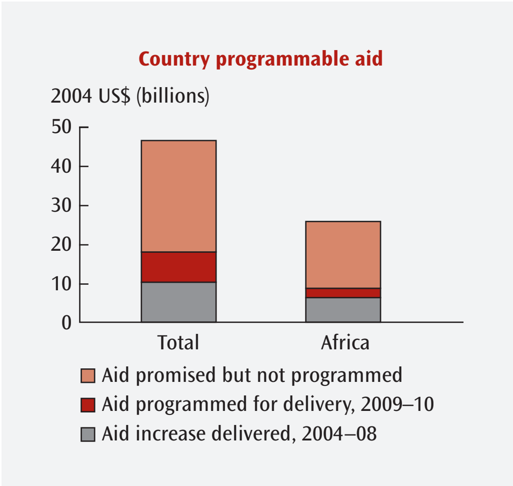
Non-DAC official donors' aid—growing in importance. Aid from non-DAC donors continued on a strong upward trend in 2007, and preliminary data show that some donors posted large increases in 2008 as well. ODA for donors reporting to DAC was $5.6 billion in 2007, an increase of 7.5 percent over 2006 levels and 50 percent over 2004 volumes. Arab donors provided $2.6 billion in assistance, led by Saudi Arabia with $2 billion. ODA from non-DAC Organisation for Economic Co-operation and Development (OECD) countries was $2.1 billion, nearly double the 2004 level, with the Republic of Korea and Turkey providing well over $500 million each in aid. Among nonreporters, Brazil's assistance was estimated at $437 million, India's development cooperation expenditure was about $1 billion, and the Russian Federation's an estimated $210 million.[16] Official numbers are not available for China's aid, but estimates place this amount at about $1.4 billion in 2007.[17] South-South cooperation is beginning to provide larger amounts of resources for development, particularly in the productive sectors and infrastructure, areas that had received less attention from DAC donors in recent years. The rise in non-DAC ODA increases the importance of efforts to improve the availability of information about these flows and enhance coordination between all donors.

FIGURE 4.2 Increase in donor financing for infrastructure in Sub-Saharan Africa



Source: ICA 2007.
Note: Consortium members include G-8 bilateral donors and multilateral agencies.

FIGURE 4.3 Gap between forward aid plans and required increases



Sources: OECD 2009a and 2009b and staff estimates.
Note: The figure is based on survey results of donors' indicative aid plans.

Sovereign wealth funds. The growth of sovereign funds holds the promise of an additional source of development finance. The IMF estimates that $2 trillion to $3 trillion is held in sovereign wealth funds (SWFs) and that this amount could reach $6 trillion to $10 trillion by 2013.[18] These valuations will now be lower as a result of the decline in asset values caused by the financial crisis. According to the Global Financial Stability Report, governments establish SWFs for several reasons: stabilization funds, savings funds for future generations, reserves investment corporations, development funds, and contingent pension reserve funds.[19] These objectives depend upon country circumstances and can change over time. Sovereign wealth funds have the potential to become a significant source of development finance.

Although the bulk of SWF resources are invested in industrial countries, these funds are beginning to invest in emerging markets as well, especially in Asia. Portfolio diversification could motivate these funds to invest in other developing countries, including those in Africa. Through its recently established Sovereign Funds Initiative, the International Finance Corporation (IFC) is attempting to connect long-term commercial capital from state-owned investors with the large and growing investment needs of private companies in developing countries. The initiative leverages IFC contributions of up to $200 million to raise $1 billion from sovereign saving pools—SWFs, superannuation funds, pension schemes—to invest in equity in "frontier emerging markets" in Africa and Latin America and the Caribbean.[20]

The Global Financial Crisis Is Jeopardizing ODA Prospects

Prospects for reaching the 2010 targets have become more uncertain. Even before the financial crisis, the gap between aid commitments and aid delivery was large. The crisis has heightened concerns that aid budgets will come under pressure, further jeopardizing attainment of the 2010 aid targets. In October 2008 the heads of OECD and DAC called on major donors to stand by their aid pledges. At the Monterrey Follow-up Conference on Financing for Development (in Doha), participants underscored the importance of meeting aid commitments. At the recently concluded London summit of the Group of Twenty (G-20), donors reiterated their commitment to meeting ODA pledges made at Gleneagles. But whether donor agencies will be able to hold the line in what are likely to be tough domestic budget negotiations and meet these pledges remains to be seen. Ireland has already announced a cut of nearly €100 million (a 10.6 percent decline) in its 2009 aid budget,[21] and there are indications that Italy's aid budget may also be cut.[22] An exception is Japan, which promised recently (at Davos) to augment its ODA by about 20 percent over the next three years.[23]

The impact of the current global crisis on development assistance will depend upon the severity and duration of the crisis. Evidence from recent slowdowns suggests that the association between aid disbursements and donor output is ambiguous, especially over shorter periods, and that aid is quite resilient to mild recessions—that is, it is not procyclical with respect to donor country output in a mild, short-duration crisis.[24] For example, ODA from the United States has actually increased in periods of declining national income; in 2001 and 2002, U.S. aid rose despite an eight-month recession in 2001 linked to the bursting of the dot-com bubble.[25]

But history also suggests that the longer and deeper the crisis, the larger the impact. Recent historical evidence shows that aid has contracted in periods of financial crisis. Finland, Norway, and Sweden all dropped their aid significantly following these countries' financial crises in 1991.[26] In the aftermath of the financial crisis, Finland's economy contracted by 11 percent and its aid by 60 percent. Moreover, aid recovery was slow following the financial crises in these countries: Norway and Sweden saw a recovery to precrisis aid levels in six to nine years, but

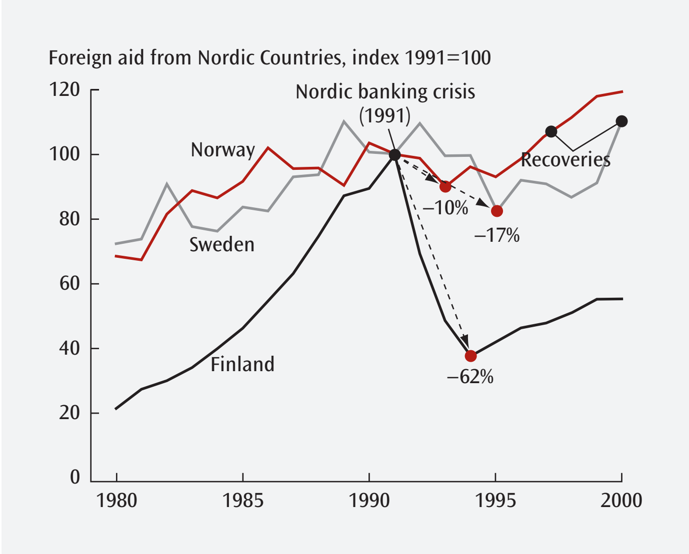
Finland's aid has yet to surpass precrisis levels (figure 4.4). Japan, which experienced a collapse of asset market prices in 1990, saw a sharp drop in aid flows as well. Based on these findings, the outlook for aid in the current global downturn is not encouraging.

The weight of empirical evidence suggests that deterioration in advanced countries' fiscal situation is likely to have adverse consequences for aid budgets. A study of the macroeconomic determinants of foreign aid notes that because aid is a discretionary item in government budgets, it is a function of a country's fiscal situation.[27] Using a sample of 15 donor countries for 1980–2004, the study finds that gross public debt is a significant determinant of aid: a 10 percent increase in the ratio of public sector debt to GDP is associated with a decline of 0.012 percent in the share of aid in GDP in the short run and of 0.023 percent in the long run (figure 4.5). Overall, the stance of fiscal policy has a statistically significant impact on aid. Thus a large deficit along with a high stock of public debt would be a drag on foreign aid. The study also finds that European Union countries' foreign aid is more sensitive to fiscal conditions than aid in other developed countries. With advanced-country governments poised to take on large amounts of debt stemming from stimulus packages and bank bailouts, the consequences for ODA in the medium term could be severe.

Aid volumes are affected by currency movements as well. Because aid budgets are set in donors' own currency, the recent appreciation of the U.S. dollar against most major currencies will deflate aid volumes measured in current dollar terms. Aid wiped out by currency movements in 2009 could be on the order of $3 billion to $5 billion (box 4.1). The analysis here is in U.S. dollars because international targets for ODA are in U.S. dollar terms. The outcome would be different if another currency was used as a benchmark.

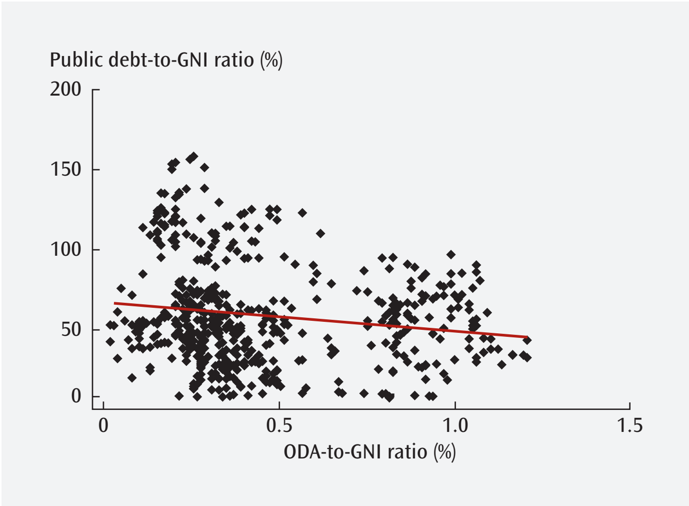
Will public support for development aid remain high? Any discussion of the impact of the current global crisis on aid needs to address the importance of noneconomic factors, such as security and national concerns and public opinion, in motivating aid. Public opinion toward aid in donor countries is an important factor determining aid levels.[28] One examination of public attitudes toward foreign aid finds that individual

FIGURE 4.4 Financial crisis and aid response



Source: Roodman 2008.

FIGURE 4.5 Ratios of public debt and ODA to gross national income for 22 DAC donors, 1980–2007



Sources: Faini 2006 and staff estimates.

BOX 4.1 The indirect impact of the crisis on aid flows

Worries that the financial crisis may make some donors less willing to give aid are justifiable. But that direct effect of falling aid dollars may be compounded by the indirect effect that is happening through exchange rate movements. When donor governments allocate aid resources they do so in their local currency. Hence, the real value of aid to recipient countries hinges, in part, on currency exchange rates. Unfortunately, recent currency movements stand to lower the value of aid in 2009.

The global financial crisis has produced an appreciation of the dollar against many donor currencies. The euro, for example, was worth 18 cents less in February 2009 than its average for 2008. Even if European aid levels stay constant ($32.8 billion in 2007, in nominal terms, from Euro Area bilateral donors and the European Commission), this exchange rate adjustment translates to a $3.9 billion loss in the value of aid. Similarly, the pound sterling is worth 38 cents less, depressing U.K. aid contributions by $1.1 billion. And the SDR (special drawing right)—which is assumed to be a good proxy denomination for multilateral funds—has fallen by 8 cents against the dollar: a $1.4 billion loss. Smaller donors like Australia, Canada, and Norway have also seen their currencies drop. Among major donors, only the yen has appreciated, pushing up the value of Japan's contribution.

Aggregated across all donors, exchange rate movements could depress the value of aid by nearly $8 billion. Of course, not all aid resources are affected by currency movements in the same way. Technical cooperation, for example, is less sensitive to currency movements; more often than not, these resources are used to pay donor-country consultants in donor-country currency and so the real value may be unaffected. Debt relief and certain forms of humanitarian assistance operate in a similar way. Considering these types of aid, a rough estimate of aid wiped out by currency movements in 2009 is $3 billion to $5 billion.

Exchange rate changes and the value of aid

Donor	Currency	2007 ODA, nominal US$ (millions)	Exchange rate change (against dollar), 2008 average to 02/09/09	Change in value of aid, US$ (millions, held at 2007 levels)
DAC European Union members (less the United Kingdom)	euros	21,694	–0.177	–2,606
European Commission	euros	11,095	–0.177	–1,333
Multilateral funds	SDRs	27,457	–0.083	–1,437
United States	dollars	18,901		0
United Kingdom	pounds sterling	5,602	–0.376	–1,135
Japan	yen	5,778	0.001	709
Other donors		14,529		–1,913
All donors, total		105,056		–7,716

Source: Kharas 2009.

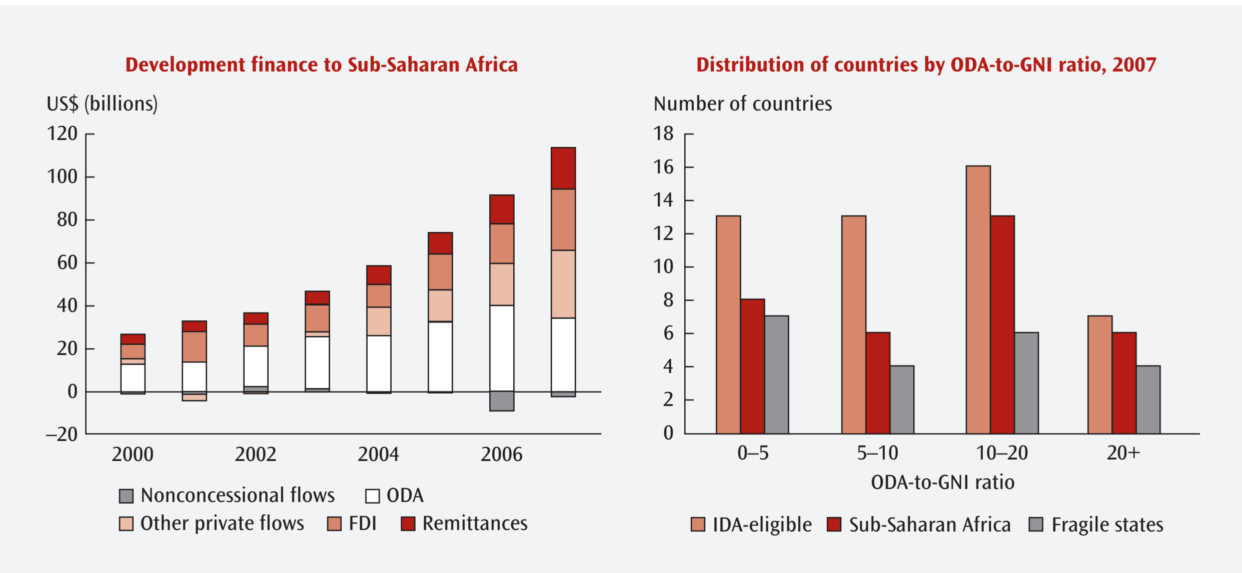
factors such as religiosity, attitudes toward poverty, attention to international news and events, and trust in others are important in influencing people's support of aid.[29] The good news is that public support for helping poor countries to develop has consistently been above 70 percent during 1983–2004 and was above 90 percent in 2004.[30] Recent evidence suggests that support for development assistance remains high in donor countries. For example, results from a French poll conducted in October 2008 reveal that over three-quarters of those polled favored maintaining or increasing aid to poor countries, despite the financial crisis, and only a fifth favored decreasing aid. These attitudes, however, may not be immune to the severity and duration of the crisis. Continued strong public support for development aid in donor countries will be an important element in the aid response to the current financial crisis.

Poor countries will be especially hard hit by any contraction in assistance. Aid constitutes a dominant share of external resources in these countries, despite the growing importance of other sources of development finance. Figure 4.6 shows that in nearly 50 percent of poor countries (IDA-eligible countries), the share of ODA is over 10 percent of recipient GNI. Over four-fifths of these highly aid-dependent countries are in Sub-Saharan Africa; several of them are also fragile countries. Aid also makes up a large share of fiscal revenues; for example, aid accounted for around 40 percent of budget revenues in Ghana and Mali in 2006. Many poor countries also rely heavily on remittances, so a slowdown in remittance receipts is worrisome as well. Following a sharp deceleration in 2008, remittance growth is projected to turn negative in 2009. Sub-Saharan Africa could see a downturn of at least 4.4 percent. Varying country circumstances will translate into differential impacts on countries, but several countries could face both an aid and a remittance squeeze.

Aid Effectiveness Agenda: Improving Aid Delivery

The 2005 Paris Declaration on Aid Effectiveness has generated a common sense of purpose and a momentum for change, but concrete actions to advance aid effectiveness are lagging. Evidence from the OECD 2008 monitoring survey on aid effectiveness shows a lack of progress toward Paris targets.[31] The survey results point to considerable variation across both indicators and countries. One area of notable improvement is the quality of country systems for managing public funds. Substantial progress has also been made in untying aid and in coordinating technical cooperation.

FIGURE 4.6 Dependence on aid remains high in low-income countries



Sources: OECD database; World Development Indicators; Global Development Finance databases; staff estimates.
Note: Data on ODA/GNI are for 49 IDA-eligible countries. The Sub-Saharan Africa and fragile states groups are not mutually exclusive.

A recent study finds a strong relationship between the quality of country public financial management (PFM) systems and donors' use of those systems (figure 4.7).[32] The quality of PFM systems remains significant when controlling for donor characteristics, other recipient characteristics, and the donor share of aid in country. The study also finds that when donors have a larger presence in a country, they have a larger stake in overall country outcomes and in using country systems, which in turn strengthens country ownership and PFM capacity.

The monitoring survey presents a mixed picture for Africa. Progress on some indicators such as untying of aid is similar to the global average, but improvement is much slower in most other areas. Particularly sobering is the weaker performance, relative to the 2005 baseline, on the use of country systems and on donor coordination of missions and country studies.

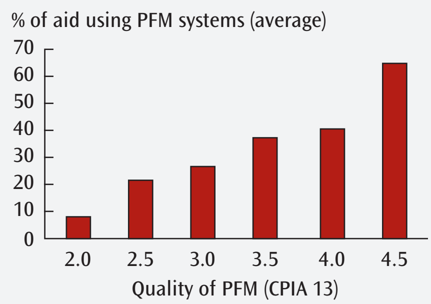
At the Third High-Level Forum on Aid Effectiveness, held in Accra in 2008, donors and partner countries recognized the need to address three key challenges to accelerating progress on aid effectiveness: country ownership of development priorities, effective and inclusive partnerships, and achieving and accounting for development results. The Accra Agenda for Action calls for strengthening country ownership by broadening country-level policy dialogue to include parliaments, local governments, and civil society organizations; enhancing the capacity of developing countries to lead and manage development processes; and increasing the use of developing-country systems as a first option.

Building effective and inclusive partnerships for development will require partnerships that embrace all development actors—bilateral, multilateral, private sector, global funds, and civil society organizations. The action agenda recognized the changing aid landscape: the growing scale of South-South cooperation; the increasing role of non-DAC official donors, private philanthropy, and partnerships; and the associated need for improved coordination and better information on flows from different sources. It also recognized the need for reducing fragmentation of aid and further untying aid.

The need for better aid information could be helped by the International Aid Transparency Initiative, which was launched by the United Kingdom and other public and private donors at the High-Level Forum in Accra. The initiative is looking into ways to improve the reliability, detail, and timeliness of information on public and private aid.

A particular focus of the action agenda is delivering and accounting for development

FIGURE 4.7 Quality of PFM systems affects donors' use of those systems



	Donor aid	
Paris monitoring indicator	Share < 0.05	Share > 0.05
Share of aid using PFM systems (average)	32.2	36.7
Share of aid in direct budget support (average)	8.5	18.7
Share of aid using program-based approaches (average)	28.6	38.2

Source: Knack 2009.
Note: Country Policy and Institutional Assessment (CPIA) data are for 2006. Higher rating denotes better performance.

results. The action agenda calls on donors to align their monitoring with country information systems and to support measures to strengthen developing countries' national statistical capacity and information systems. It also calls on donors and developing countries to jointly determine conditions for aid disbursements, with conditions to be based on developing countries' national development strategies. Other actions include increasing the medium-term predictability of aid—for example, donors providing three-to-five-year forward spending plans. The results of the latest OECD monitoring survey show that on average only 45 percent of aid is delivered on schedule.[33] Budget support survey data from the Strategic Partnership for Africa also show that forward projections of aid can be very unreliable. Using aid projections and outturns data derived from macroeconomic programming exercises by IMF staff, one study found that on average disbursements of budget aid differed from projected amounts by about 30 percent.[34] The follow-up conference at Doha also focused on improving the quality of aid. Participants reiterated a need to make aid more predictable by regularly providing developing-country partners with multiyear indicative information on forward spending plans.

Along with improving aid predictability, donors also need to turn their attention to the issue of aid volatility. Aid flows tend to be more volatile than other forms of revenue and output.[35] Uncertainty of aid flows diminishes the true value of these resources. One study uses the concept of "certainty equivalence" to estimate the cost of volatile flows at 15–20 percent of the total value of aid.[36]

Implementing the Accra Agenda for Action requires strong political support and coordinated action among all actors. The challenges to implementation are neither new nor simple. It remains to be seen whether donors will be able to step up the pace of reform. Improving the quality of aid has taken on an added urgency in the face of pressures on aid budgets. The current crisis should give an impetus to implementation of the Accra agenda.[37]

Mobilizing Private Aid for Development

Private actors, particularly foundations and businesses, are becoming increasingly important players in development finance. Along with new resources, private participation brings innovation. Private giving has shifted from the traditional charity approach to one of active participation by private donors in the aid community, including bringing a business approach to development assistance.

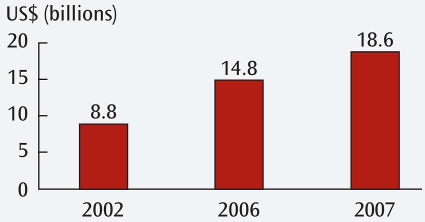
Trends in Private Giving

Comprehensive data on private giving are not available, but all indications point to a large and growing amount of private resources being devoted to development purposes. Private international giving as reported to the OECD shows a strong upward trend in grant making. Private giving for international purposes climbed to $18.6 billion in 2007, bucking the recent slide in official aid and representing more than a 25 percent increase over 2006 levels (figure 4.8). The 2007 increase was driven by a surge in private giving in the United States, which accounts for 65 percent of the total. Canada (7.5 percent) and Germany (7 percent) accounted for sizable shares in total private giving as well, closely followed by the United Kingdom (3.7 percent) and Australia (3.6).

Although large, these numbers do not capture the full extent of private giving. For example, corporations are not included, and some countries do not provide any reports. The Hudson Institute estimates that the extent of underreporting is large. For the United States alone the institute estimates that private international giving by foundations, corporations, educational institutions, religious organizations, and private and voluntary organizations was $36.9 billion in 2007—three times the $12.2 billion

FIGURE 4.8 Private grants data: undercounting philanthropy

Grants by private voluntary agencies as reported to the OECD



Gaps in grants data reported to the OECD in 2007
US$ (billions)

	Reported	Estimates
United States	12.2	36.9
United Kingdom	0.67	4.12
France	Not reported	1.03
Norway	Not reported	0.25
Spain	Not reported	0.36

Sources: OECD database; Hudson Institute 2009; GuideStar Data Services.

reported to the OECD.[38] Likewise, international giving by the United Kingdom was $4.1 billion, six times the reported amount. Private giving by France, Norway, and Spain is not captured in the DAC numbers but is estimated at a combined $1.6 billion.

Foundations and corporations are the most dynamic sectors of private philanthropy. U.S. giving is spurred by the activities of foundations.[39] According to the Foundation Center, there are over 72,000 grant-making private and community foundations in the United States, which contributed an estimated $5.4 billion in 2007.[40] The growth in international giving has far exceeded that of general foundation giving since 2002. The trend in giving is dominated by the Bill and Melinda Gates Foundation. At $2 billion in 2006 (and $2.4 billion in 2007), international grants awarded by this foundation are larger than the combined international grants of the next 14 largest foundations. Increased funding by the Gates Foundation accounted for most of the growth in the share of international giving in total giving by foundations: from 13.8 percent of total giving in 2002 to 22 percent in 2006. This share would have grown even without the Gates Foundation, albeit more modestly from 11 percent to 13 percent. A substantial part of funding to developing countries targets health, but support in other areas such as education and relief efforts has also increased.

Corporate giving is on the rise as well. Results from a survey of U.S.-based companies and corporate foundations indicate that these institutions contributed around $2.3 billion annually in 2006 and 2007 for international development assistance. About two-thirds of this amount was provided in the form of goods and services rather than as cash. The industry with the largest international donations was the pharmaceutical sector—10 pharmaceutical companies reported contributing $1.5 billion internationally in 2007.[41]

The European foundation sector has also been growing, and the number of public-benefit foundations increased by more than 54 percent between 2001 and 2005.[42] But data on European foundations are even more incomplete. Based on a 2007 survey by the European Foundation Centre, European foundations gave $607 million in 2005. Like the U.S. foundations, much of this was directed toward health, followed by education.

Injecting Entrepreneurship in Aid

Private involvement in aid is transforming philanthropy, with traditional giving being replaced by entrepreneurship in aid. The new philanthropists want to bring a business approach to aid and international development—“philanthrocapitalism.”[43] The philanthrocapitalist model applies market-based principles to development: problem solving, taking risks, fostering innovation, managing organizational structures, mobilizing media attention to set the agenda, and measuring success.[44] Private engagement is particularly strong in health, education, humanitarian assistance, and climate change activities.

Global corporate citizenship is leading to an increased engagement of business in development. The concept of global corporate citizenship recognizes that businesses are stakeholders in development; in other words, development impacts business. Thus business needs to be committed to addressing global challenges such as public health care, climate change, and environmental sustainability. The involvement by business in development is manifested in several ways: engagement in the community, which is essentially philanthropic (businesses provide money to support good causes but also involve staff in fundraising activities or working on local community projects such as a school, health facility, or training center); commitment to corporate social responsibility, that is, adoption of minimum standards regarding labor practices, the environment, and transparency; enhancement of the development impact of business activity, particularly through research and development, supply chains and subcontractors, and distribution networks; and contribution to global public policy.[45] Because business involvement in development brings more than funding, these contributions are not adequately counted (box 4.2).

The Global Financial Crisis and Prospects for Private Aid

The current global crisis could interrupt the rising trend in private aid. As with official aid, the impact will depend upon the depth and duration of the crisis. Also, the short- and medium-term impacts of the crisis are likely to be different. Nonetheless, the crisis is likely to have a significant negative effect on the ability of foundations, corporations, and individuals to make new and additional philanthropic commitments. Corporate profits are already adversely affected, and a broad-based decline in financial assets is likely to lower the value of foundations' endowments and their returns. Given difficult economic conditions in their home countries, many philanthropic organizations could pull back their international support and focus more of their resources on local or domestic causes.

Despite a difficult economic environment, some large foundations have issued statements indicating their intentions to maintain grant levels. For example, the Gates Foundation has announced an increase in its total giving for 2009—$3.8 billion compared with $3.3 billion in 2008, representing 7 percent of its assets as opposed to about 5 percent in previous years.[46] This increase comes in the face of a 20 percent decline in the foundation's assets in 2008. The MacArthur Foundation has announced that it plans to maintain grant-making levels in 2009 despite significant endowment losses.[47] But some other foundations have expressed difficulty in maintaining current levels and have even indicated a cutback. For example, the Hewlett Foundation has announced that grants will likely be 5–7 percent lower in 2009 than in 2008.[48]

Past patterns provide some insights on how grant making has been affected by economic crisis. A review of foundations' giving from 1975 to 2007 shows that during the previous recessionary periods of 1980, 1981–82, and 1990–91, grant making held up fairly well.[49] In the 2001 recession, grants declined slightly, but far less than the 10 percent decline in the value of foundations' assets during 2000–02 (figure 4.9). A large number of foundations base their grant budgets on a rolling average of their asset values over two to five years, a practice that helps smooth the effects of asset price fluctuations. Some foundations even increased their payout rate in the 2001 recession to provide resources for activities that they had been supporting over time. New gifts

BOX 4.2 Contributions of private actors to development in Sub-Saharan Africa

Early findings from an ongoing study sponsored by the W. F. Kellogg Foundation, the government of Norway, and the World Bank suggest that private actors in Sub-Saharan Africa are contributing to solving development problems in a variety of ways. Private corporations bring more than just funding. They provide opportunities, especially at the local level, to tackle problems that are meaningful for their company, the community, and the country. Trends indicate an increasing space for collaboration and attention to scale and sustainability.

The study finds that corporate contributions are often underrepresented in calculations that are based on corporate social responsibility (CSR) budgets or "giving" programs. Capturing the expenditures on other "core business" activities that have positive spillover effects is difficult, but the results are no less important.

- In Ghana, the idea of harnessing mainstream business operations and not just CSR budgets for development impact is being adopted by some companies. A good example is Standard Chartered Bank (Gh). This bank has shifted from CSR to the concept of sustainability—a way of doing business that is fundamental to its strategy, is embedded across its businesses, and contributes to shareholder value. The bank realizes that it can have a positive impact on the environment and society, as well as on building a sustainable business, if it focuses on enhancing the economic development of the country in which it operates.
- Another example of company activities that benefits both the affected communities and the company is the malaria program at AngloGold Ashanti's Obuasi mine (Ghana). This $1.3 million-a-year program has helped reduce malaria incidence at the local hospital from 79,000 cases in 2005 to 21,000 in 2007. The malaria incidence rate among the mine's employees dropped from 238 to 69 over the same period. In addition, the program created 116 jobs and developed ongoing community interaction to sustain the efforts.
- In Uganda, early estimates show that the corporate sector provides basic services at the community level in which the companies work; however, specific investment figures are difficult to obtain.

Headquarter surveys of foundations, corporations, and nongovernmental organizations (NGOs) suggest that more attention is being given to increasing the impact of single interventions, replicating successful models, and ensuring the sustainability of benefits after the private programs are completed. Firms, foundations, and NGOs are looking for ways to leverage collaboration among themselves and with traditional donors and governments to strengthen the probability of achieving short- and long-term results.

Governments play an important role in facilitating private engagement in development and enhancing its effectiveness. In Sierra Leone, for example, the government is mapping how and where private actors are contributing to health care service delivery. The view is that by knowledge sharing and collaboration, scarce resources can be better allocated and opportunities for strengthening institutional systems or sharing lessons can be facilitated. In Liberia, strong leadership by the government is encouraging private actors to align their contributions in finance and capacity building to the country poverty reduction strategy.

Source: White, Bastoe, and Curry 2009.

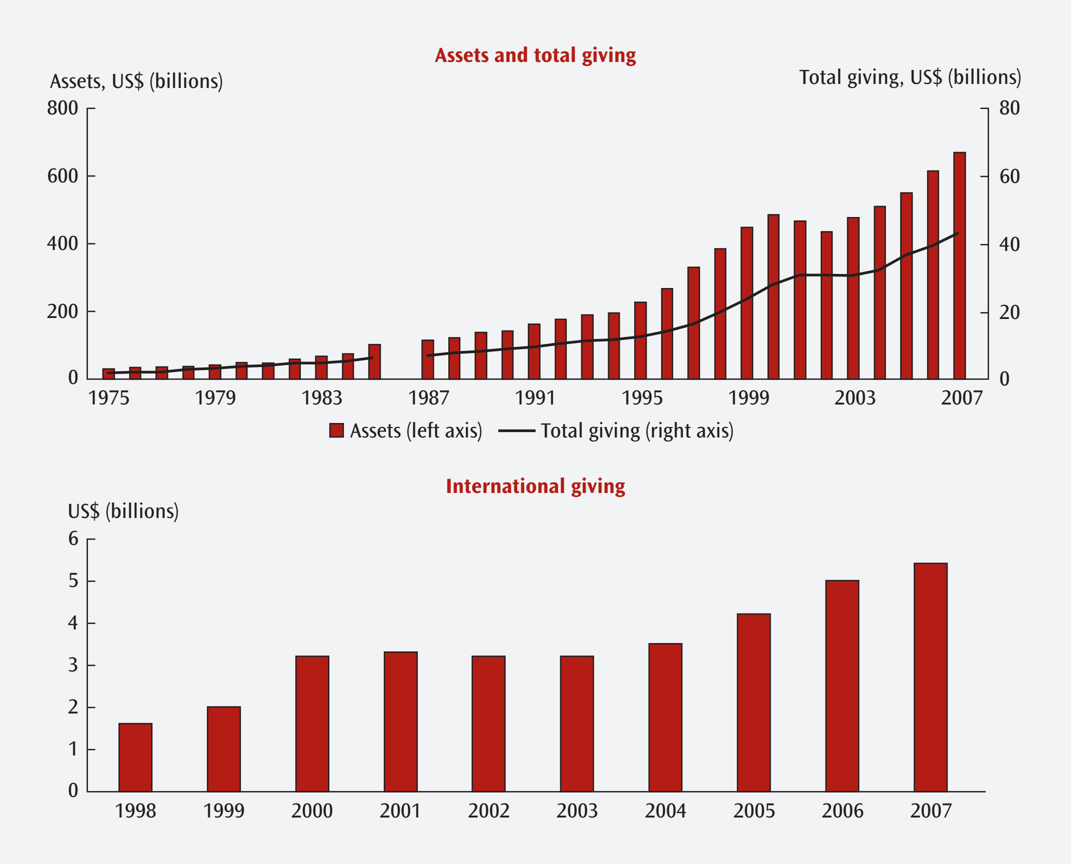
and bequests and a growth in the number of foundations also helped to reduce the decline in grant volumes. A long and pronounced decline in foundation assets would have troubling consequences for grants, however.

The Foundation Center's analysis of trends in U.S. foundation grant making (excluding the Gates Foundation) also shows that the relative share of resources devoted to international giving remained fairly stable during the economic downturn in 2000–02.[50]

Public-Private Partnerships and Innovative Financing Mechanisms

The growing presence of private actors in aid and development is fostering partnerships between private entities and public institutions. Several factors are motivating this partnership. One is a recognition that official assistance is not enough for meeting the MDGs and related development goals and that private resources, both foreign and domestic, are also needed. A second is the

FIGURE 4.9 Trends in U.S. foundations' assets and giving



Source: Foundation Center 2008c.
Note: Data on foundations' assets and giving are not available for 1986. Data include the Gates Foundation.

recognition that private participation can bring an increased focus on efficiency and performance and spur innovation.

Through innovative instruments and mechanisms for development, progress is being made on a range of complex issues related to key global priorities, in particular in the areas of health, education, and climate change, as well as on specific country-level challenges. Innovative finance activities and mechanisms are tapping new sources of finance and new actors. Flows from innovative financing approaches are growing.[51] The International Finance Facility for Immunization has raised $1.6 billion, the Advance Market Commitments $1.5 billion, and (PRODUCT)RED™ over $100 million. The Solidarity levy on airline tickets raised €160 million from France in 2008, and proceeds from auctioning or selling project-based carbon emissions permits under the European Union's Emission Trading System raised €120 million (for investment in climate protection measures in developing countries) from Germany in 2008.[52]

In addition to identifying and efficiently using new sources of public and private funding, innovative financing mechanisms help manage the risks and costs of vulnerability (for example, to weather and to currency and interest rate movements) facing developing countries and provide incentives for implementation. One way that these objectives are achieved is by leveraging private resources to support public purposes in developing countries. An example is the International Finance Facility for Immunization, which front-loads bilateral development aid by issuing bonds to finance high-return activity. Another way is by deploying public resources to reduce the costs and risks of private entry in developing-country markets, and thereby leveraging private investment in developing countries, through guarantees, risk-sharing facilities, and transactional support for public-private partnerships. Two examples are the use of carbon credits and Advance Market Commitments, which help mobilize private sector investment in vaccine development and production (box 4.3).

Financing for Combating Climate Change

Addressing climate change is central to attaining durable progress toward the MDGs and related development outcomes. *Global Monitoring Report 2008* provided a detailed discussion on the importance of integrating environmental sustainability into core development work. As policy makers focus on addressing the immediate fallout from the current global crisis, they must not shift attention away from the longer-term climate change challenge. Tackling climate change will require mobilizing substantial financial flows—public and private—to developing countries, much beyond current levels.

The investment needs are large. To stabilize greenhouse gas atmospheric concentrations at levels that are considered reachable and manageable, the latest estimates suggest that additional investment required in developing countries will range from $150 billion to $200 billion per year over 2010–20 and will rise to $400 billion per year on average beyond 2020. Estimates vary depending on assumptions, especially regarding the ambition of long-term stabilization targets and the nature of policies adopted to curb greenhouse gas emissions, in particular, the type of instrument, the degree of global participation, and the contribution of various sectors. The estimates also vary depending on perceptions of the scope for cheap energy efficiency

BOX 4.3 Advanced market commitments: promoting private investments by leveraging public funds

An advance market commitment (AMC) tackles a long-standing development problem—persistent private sector failures to develop and produce goods needed in developing countries because of perceived insufficient demand or market uncertainty. The pilot focuses on the vaccine market, where research, development, and production of vaccines specific to the needs of the poorest developing countries are limited by the small number of manufacturers, high cost of product development and capacity scale-up, and demand uncertainty. With an AMC, public financing leverages private funds, spurring private sector investment in research, development, and distribution of vaccines.

Official and private donors—Canada, Italy, Norway, Russia, the United Kingdom, and the Bill and Melinda Gates Foundation—have pledged $1.5 billion for a pilot AMC for vaccines against pneumococcal diseases. (The Global Alliance for Vaccines and Immunization will support the AMC operationally and the World Bank will provide the financial platform.) The pilot AMC offers a subsidy to purchase eligible vaccines in exchange for a long-term commitment to supply the vaccine at a low price. For the pilot AMC, donors first commit funds appropriate for a predetermined market size and price with specifications targeting effectiveness and development impact in developing countries. Second, as and when the vaccine becomes available, a credible independent body will determine if the new vaccine meets the target specifications. Approval by that independent body entitles a manufacturer to enter into a supply agreement giving it access to AMC funds subsidizing the purchase of the vaccine. Finally, when AMC funding is depleted, the manufacturer will continue to provide the vaccine at an established price for a specified period to meet continuing demand.

measures and opportunity costs of mitigation measures in the forestry and agriculture sector as well as on the rate of technological change and deployment of climate-friendly technologies. Research, development, and demonstration of mechanisms for producing and using cleaner and safer energy would add anywhere from $10 billion to $100 billion a year to the needed investment.[53]

Financing the costs of adapting to the inevitable amount of warming that the world will experience will also be costly, albeit the estimates of adaptation costs are very incomplete and preliminary.[54] The World Bank puts investment needs in developing countries at $4 billion a year over the next several years, rising to $37 billion a year. Estimates from other international groups working on climate change range from as low as $8 billion a year to a high of $86 billion a year by 2015. Estimates so far are dominated by the cost of climate proofing future infrastructure investments; they thus tend to overlook other forms of adaptation, such as changes in behavior, adjustments in operational practices, or relocation of economic activity. They are also influenced by the estimated level of climate change and resulting effects as well as by the scope of adaptation strategies, which reflect competing understandings of the adaptation process, in particular its relationship to development dynamics.

These needs go far beyond current and upcoming resources. Current climate-related financial flows to developing countries, though growing, cover only a tiny fraction of the estimated amounts needed (table 4.1). The bulk of available and emerging resources dedicated to climate action relates to mitigation (at about $10 billion per year), mainly through carbon market transactions to reduce project-based emissions and to a lesser extent through the recently launched Climate Investment Funds. The Global Environment Facility has been the largest source of grant financing for energy efficiency and renewable energy, with an overall cumulative commitment of over $2.4 billion (since the early 1990s) in mitigation and capacity building. The amounts available for adaptation are about $1 billion per year.

Private sources through carbon markets are mobilizing the bulk of financial flows for mitigation. Recent years have seen strong growth in the carbon market and in private investment in clean energy. The carbon market, the largest share of which is accounted for by the European Union Emission Trading Scheme, was valued at about $120 billion in 2008 (over 12 times its 2005 value). About 2.1 billion metric tons of carbon dioxide equivalent emission reductions have been transacted over 2002–08 under the Clean Development Mechanism (CDM) for an approximate value of $24 billion.[55] It is estimated that some $52 billion in clean energy investment has benefited from this mechanism over 2002–07.[56]

TABLE 4.1 Current dedicated resources for climate change in developing countries
US$ (billions)

Mitigation		Adaptation	
Global Environment Facility, per year	0.25	Least Developed Country Fund, Special Climate Change Fund	0.3
Carbon market, per year	8+	Adaptation Fund	0.3–.0.5
Clean Investment Funds	5+	Clean Investment Funds	≈ 0.5
Other, per year	1+	Other, per year	0.4+
Total, per year	≈ 10	Total, per year	≈ 1

Source: World Bank 2008 and staff estimates.

Much of the financial support for adaptation comes from international donors. Donors have pledged resources through both bilateral and multilateral initiatives, but existing resources and financing instruments for adaptation are modest. An important development is the establishment of the Adaptation Fund, which should provide a boost to mobilizing resources for adaptation (box 4.4). Other sources are the United Nations Framework Convention on Climate Change Special Funds (administered by the Global Environment Facility), made up of a $180 million fund for least-developed countries and a $90 million Special Climate Change Fund, and the Global Facility for Disaster Reduction and Recovery ($40 million in fiscal 2008).

The international community had an estimated $9.5 billion invested in climate-friendly funds—public and private—in 2007, and the size of the funds grew in 2008. Several new bilateral funds have been created by donors to support climate change activities, primarily mitigation—pledges that total $2.7 billion a year over the next few years.[57] Official flows are important for correcting market imperfections, building capacity, and targeting certain areas. Because bilateral initiatives represent ODA, one issue that arises is whether these new flows dedicated to climate change are additional to other ODA commitments. Another issue involves the implications that the proliferation of specialized funds could have for effectiveness of resources. Among multilateral programs, the largest is the Climate Investment Funds Initiative (established by the World Bank jointly with the African Development Bank [AfDB], the Asian Development Bank [ADB], the European Bank for Reconstruction and Development [EBRD], and the Inter-American Bank [IDB]), which is designed to provide

BOX 4.4 The Adaptation Fund: country ownership in adaptation finance

Under the UN Framework Convention on Climate Change process, the Adaptation Fund is intended as a principal source of adaptation support for developing countries and a centerpiece of the international agenda on climate change. The fund is designed to finance concrete climate change adaptation projects and programs that are country driven and based on needs, views, and priorities of eligible developing-country parties to the Kyoto Protocol.

The fund's primary financing comes not from traditional development assistance, but from a 2 percent share of proceeds of certified emissions reductions (CERs) issued by the Clean Development Mechanism (CDM) under the Kyoto Protocol. The Adaptation Fund's financial base is thus precedent-setting: an international base arising from an international treaty. Using a share of the proceeds from CER sales to assist developing countries was envisioned when the Kyoto Protocol was agreed in 1997; the Adaptation Fund was allocated a 2 percent share in 2001.

As of January 12, 2009, the Adaptation Fund held about 4.9 million CERs. Current estimates by the UN Environment Programme's Riscoe Center suggest that the Adaptation Fund will receive about 30 million CERs by 2012. In November the center estimated that a total of 1.518 billion CERs would be issued by 2012, based on the current CDM pipeline and historic approval rates (http://www.cdmpipeline.org/).

The governance of the Adaptation Fund reflects its innovative source of financing. It assigns true ownership to developing countries. Accordingly, 75 percent of the Adaptation Fund Board is made up of representatives from developing countries, including the most affected countries (small island developing states and least-developed countries), and it provides that they can submit proposals directly to the Adaptation Fund Board. The World Bank serves as a trustee to the Adaptation Fund, performing two core functions, trust fund management and monetization of CERs for the Adaptation Fund. The Global Environment Facility serves as its secretariat. Monetization of CERs will start in 2009.

Source: Multilateral Trustee and Innovative Financing Group.

interim, scaled-up funding in the form of grants and concessional financing to help developing countries in their mitigation and adaptation efforts. In September 2009, donors pledged $6.3 billion for the Clean Investment Funds: $4.3 billion for the Clean Technology Fund and $2 billion for the Strategic Climate Fund.[58] Financial flows through CDM and these climate funds are still below required amounts.

The shortfall between needs and resources available for meeting the challenge of climate change in developing countries is enormous. Scaling up financing for climate change in the current global economic environment will be even more of a challenge. In this context it is important to explore synergies in proposed solutions and responses, for instance incentives for energy efficiency improvements, investments in renewable energy sources, and investments in greener infrastructures. Reforming existing market-based mechanisms to boost mobilization of funds and channel investments toward developing countries should also be a high priority, along with increased resource mobilization for adaptation.

Debt Relief: Progress and Challenges

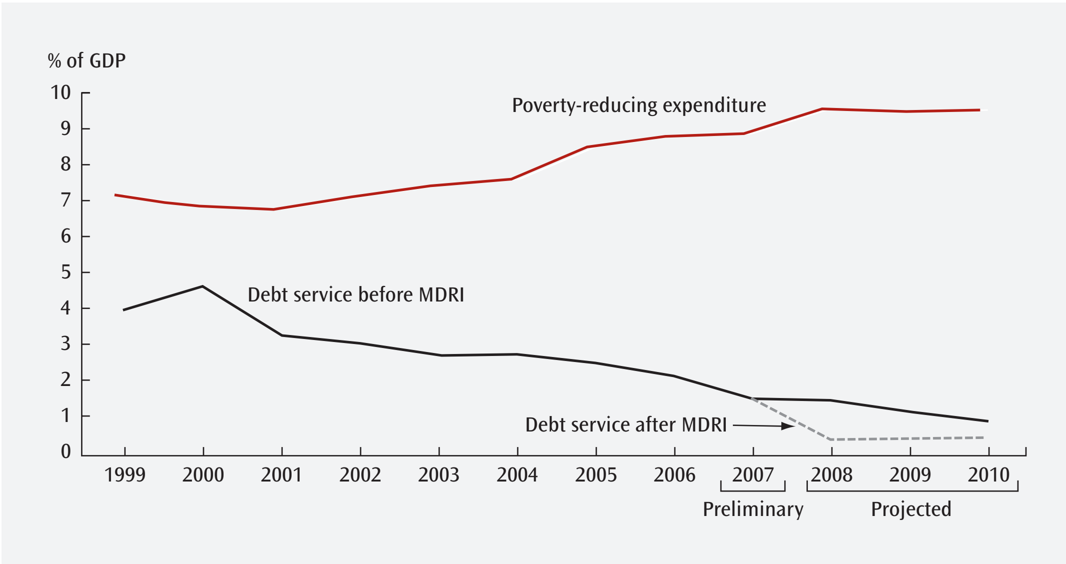
The international community reached a consensus in Monterrey in March 2002 on a global response to address the challenges for financing development, including through debt relief. It was agreed at that time that external debt relief could play an important role in liberating resources that could help foster sustainable growth and development and accelerate progress toward the MDGs. More specifically, the consensus called for the speedy, effective, flexible, and full implementation of the HIPC Initiative, which should be fully financed through additional resources. In 2005, the HIPC Initiative was supplemented with the MDRI, whereby four multilateral financial institutions (IDA, the IMF, the AfDB, and the IDB) provide additional debt relief with the view to free more resources for poverty reduction and achieving the MDGs.

Substantial progress has been made since 2002 in implementing debt relief. More than four-fifths of eligible countries (35 out of 41) have passed the decision point and qualified for HIPC Initiative assistance. Of those, 24 countries have reached the completion point and qualified for irrevocable debt relief under the HIPC Initiative and the MDRI. The debt relief committed to the 35 post-decision-point HIPCs amounts to $124 billion (in nominal terms, excluding Côte d'Ivoire), including $52 billion under the MDRI. On average this debt relief represents about 50 percent of these countries' 2007 GDP.

As a result, the debt burdens of many poor countries have been reduced markedly. On average, the debt burden of the 35 HIPCs is expected to be reduced by about 90 percent, compared to their pre-decision-point debt stock. HIPCs' debt service obligations have fallen on average by about two percentage points of GDP since the late 1990s, while poverty-reducing spending has increased on average by about the same amount during this period (figure 4.10).

To facilitate the HIPCs' advances toward debt relief, flexibility has been applied in implementing the initiative while preserving its core principles.[59] However, completing implementation of the HIPC Initiative will still require sustained efforts from the international community. Many of the 17 eligible, pre-completion-point HIPCs face substantial challenges, most in noneconomic areas. Almost half have been affected by war in recent years, and many remain at a high risk of conflict, political instability, or both. Most also have weak policies and institutions. Addressing these challenges will require continued efforts from these countries to strengthen their policies and institutions, together with sustained international support. Additional resources will also have to be marshaled to finance the cost of debt relief to all pre-decision-point HIPCs, including Somalia and Sudan, two countries

FIGURE 4.10 Average debt service and poverty-reducing expenditures



Source: IMF–World Bank 2008; HIPC documents; and IMF staff estimates.

with large and protracted arrears that were not included in the original framework for financing debt relief in the IMF.

Another challenge is to ensure that the HIPCs get full debt relief from all their creditors. Although the largest creditors (the World Bank, the AfDB, the IMF, the IDB, and all Paris Club creditors) provide debt relief in line with their commitments under the HIPC Initiative, and even beyond, others are lagging behind. Smaller multilateral institutions, non–Paris Club official bilateral creditors, and commercial creditors, which together account for about 25 percent of total HIPC Initiative costs, have delivered only a small share of their expected relief so far.[60] A number of commercial creditors have also initiated litigation against the HIPCs, raising significant legal challenges to burden sharing in the context of the initiative.

The World Bank's Debt Reduction Facility (DRF) for IDA-only countries has become one of the key instruments for promoting commercial creditor participation in the HIPC Initiative.[61] Since its establishment, the DRF has supported 24 operations in 21 countries, helping to extinguish about $9 billion of commercial external debt. Over the past 12 months, the DRF has financed a debt buyback for Nicaragua and has provided support for the preparation of debt buybacks for Liberia and Sierra Leone. The DRF-supported buyback for Nicaragua extinguished close to $1.4 billion of commercial external debt (97 percent of eligible claims) on terms consistent with the full delivery of HIPC Initiative debt relief. This operation is particularly important for the DRF in that it extinguished the claims of all litigating creditors.

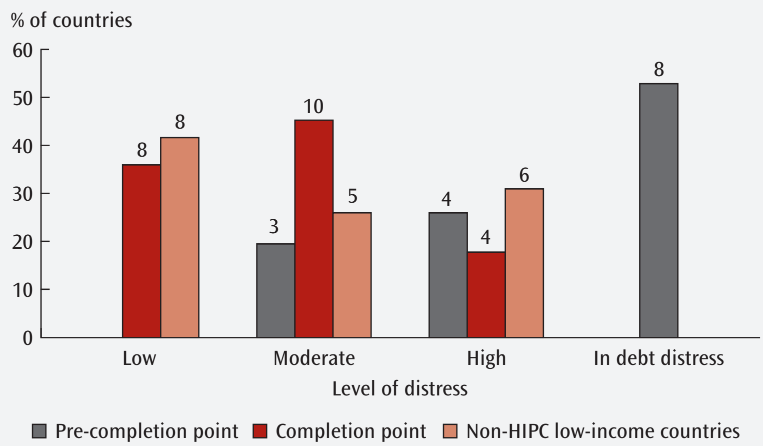
Debt relief, while welcome, addresses only a relatively small part of the HIPCs' financing needs and cannot ensure debt sustainability permanently (box 4.5). Debt relief savings accrue through time and generally constitute only a moderate share of net aid inflows to the HIPCs. Addressing development needs of the HIPCs, and more generally low-income countries, therefore requires higher new aid flows in addition to debt relief. New flows also allow for a quick and targeted response to address any emerging issues, such as the impact of the current global crisis on poor countries.

BOX 4.5 Results from low-income country debt sustainability analyses

Debt sustainability analyses (DSAs) performed under the Debt Sustainability Framework provide a comprehensive view of the debt outlook for low-income countries. Between 2005, when the framework was introduced, and March 2009, 205 DSAs covering 68 low-income countries were completed; 173 DSAs were published. Recent joint World Bank–IMF DSAs for IDA-only countries and their ratings suggest that about 29 percent of these countries have a low risk of external debt distress (see the figure below). This share is higher for non-HIPCs (42 percent, or 8 countries) and post-MDRI countries (36 percent, or 8 countries). No pre-completion-point HIPC has a low risk rating. Post-MDRI countries perform nearly as well as non-HIPCs, thanks in large measure to the provision of debt relief, which has decreased their external debt ratio considerably. Another 32 percent of IDA-only countries have a moderate risk rating. This share is again higher for post-MDRI countries (45 percent, or 10 countries) and non-HIPCs (26 percent, or 5 countries). In these countries' DSAs, vulnerabilities appear in stress tests. Debt dynamics seem particularly sensitive to shocks to exports.

Debt sustainability is a major concern for the 39 percent (22 countries) of countries rated at high risk or in debt distress. Of these 22 countries, 12 are pre-completion-point HIPCs (80 percent of this country group), 6 are non-HIPCs (32 percent), and 4 are post-MDRI countries (18 percent). Again, debt dynamics seem particularly sensitive to shocks to exports.

Risk of debt distress for IDA-only countries by HIPC status



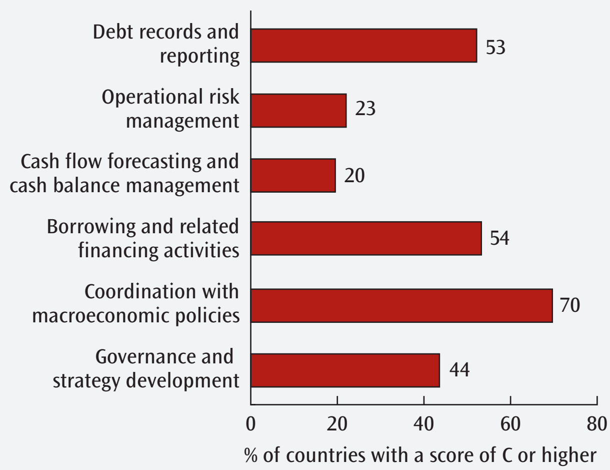
Source: Joint World Bank–IMF debt sustainability analyses.
Note: Data are for 56 low-income countries. Numbers above bars indicate number of countries.

These new flows need to be on appropriate terms to ensure that debt sustainability, which has been restored through debt relief, is maintained in the future. The joint IMF–Bank Debt Sustainability Framework for low-income countries is an important tool that supports low-income countries in their efforts to achieve their development goals, while reducing the risks of future debt problems.

Maintaining debt sustainability after receiving debt relief highlights the need for strengthening debt management in these countries. The IMF and the World Bank have stepped up their efforts to assist low-income countries to enhance public debt management frameworks and have developed a comprehensive debt management tool kit for low-income countries.[62] One building block of this tool kit facilitates assessment of a country's debt management performance using 15 indicators that span the six core functions of public debt management. This assessment, known as DeMPA, has been applied in 20 low-income and 3 middle-income countries (as of December 2008). Early results from the assessment reports are helping to identify common priority areas for debt management reform across countries. Across the six core functions, operational risk management and cash flow forecasting and cash balance management appear as key weak spots (figure 4.11). Less than half of the sample complies with minimum requirements for sound governance and strategy development.[63] Countries appear to do better in the areas of coordination with macroeconomic policies and debt records and reporting, while roughly half scored a C or higher with respect to borrowing and related financing activities.[64]

DeMPA can serve as an essential input for the second component of the tool kit—formulation of a debt management strategy that is consistent with long-term debt sustainability. The outputs from the assessment and the strategy formulation can also feed into the third building block—a reform plan. The recently established donor-funded Debt Management Facility will support a substantial scaling up of the World Bank–IMF's work in strengthening debt management capacity and institutions.

FIGURE 4.11 The DeMPA tool: assessing core functions of public debt management



Source: IMF–World Bank 2009 forthcoming.
Note: A score of C indicates the minimum requirement for effective debt management.

Notes

1. Robert B. Zoellick, "A Stimulus Package for the World," *New York Times*, January 23, 2009 (http://www.nytimes.com/2009/01/23/opinion/23zoellick.html).
2. Voluntary contributions to the World Food Programme jumped to over $5 billion in 2008 from $2.7 billion in 2007. Among the largest donors were the United States ($2.1 billion), Saudi Arabia ($503 million), the European Union ($355 million), and Canada ($275 million); see http://www.wfp.org/appeals/wfp_donors/2008.asp?section=3&sub_section=4). The World Bank established a $1.2 billion rapid financing facility—Global Food Response Program—in May 2008 to speed assistance to the neediest countries.
3. This framework has been developed by the U.N. Secretary General's High-Level Task Force on the Global Food Crisis.
4. The task force has proposed establishing a Financial Coordination Mechanism to facilitate quick mobilization and disbursement of additional donor resources.
5. IMF 2009.
6. PREM 2008, 2009a, 2009c.
7. Only a third of developing countries, and even fewer low-income countries, have reasonable fiscal capacity to expand fiscal deficits. See DEC-PREM 2009 and PREM 2009b.
8. See the UN's MDG Gap Task Force 2008 report.
9. CPA excludes debt relief, exceptional assistance such as humanitarian aid (which can rise and fall in response to unexpected events such as natural disasters) and food aid, some specific items including administrative costs, core funding

of NGOs, imputed student costs and refugees in donor countries. In 2008, CPA constituted 68 percent of total DAC ODA.

10. Chapter 2 of the report estimates the regions' financing gap in infrastructure at about $40 billion, but it also notes that factors other than financing severely hamper infrastructure services.

11. The share of infrastructure was 25 percent in 1995.

12. The consortium was established in 2005 following the Gleneagles Summit.

13. OECD 2009a and 2009b.

14. The 2009 survey on planned CPA covered 41 bilateral and multilateral donors; 35 donors responded. The forward aid expenditures are conservative estimates of future aid flows. Donors' practices regarding forward aid planning vary with regard to periodicity of updating. Some donors have annual updates of multi-year schedules while others update multi-year schedules in the context of bilateral consultations with partner countries. The Accra Agenda for Action calls on donors to provide regular and timely information on their rolling 3-to-5-year forward planned expenditures and implementation plans to developing countries.

15. This estimate assumes debt relief and humanitarian assistance will be at long-term averages.

16. OECD 2009a.

17. Brautigam 2008.

18. IMF 2008.

19. IMF 2007.

20. Frontier economies are some of the poorest developing countries.

21. http://www.irishaid.gov.ie/latest_news.asp?article=1411.

22. "Less and worse aid? Financial crisis shows first impacts on European aid budgets" http://www.eurodad.org/whatsnew/articles.aspx?id=3285.

23. http://ipsnews.net/news.asp?idnews=45625.

24. Desai and Kharas 2008; Mold, Olcer, and Prizzon 2008.

25. Desai and Kharas 2008.

26. Roodman 2008.

27. Faini 2006.

28. McDonnell, Solignac-Lecomte, and Wegimont 2003.

29. Paxton and Knack 2008.

30. Zimmerman 2008; Eurobarometer 2005.

31. OECD 2008.

32. Knack and Eubank 2009. The study uses the unweighted average of all relevant donor-recipient pairs, while the OECD results are based on aggregates for recipient countries.

33. OECD 2008.

34. Celasun and Walliser 2008. Several of the studies also suggest that while recipients' performance is an issue, many other factors, including technical, legal, and political, contribute to low predictability.

35. Bulir and Hamann 2003, 2006; Pallage and Robe 2001.

36. Kharas 2008.

37. Mold, Olcer, and Prizzon 2008.

38. Hudson Institute Center for Global Prosperity 2008.

39. There are three types of foundations—private, corporate, and community.

40. Foundation Center 2008b.

41. Conference Board annual surveys for 2007 and 2008. In 2007, 197 companies and corporate foundations participated in the survey, compared with 189 companies in 2006.

42. A public-benefit foundation is defined by the European Foundation Center as being an asset-based, purpose-driven institution that has no members or shareholders but has an established, reliable income source to carry out its work over a longer term than other institutions such as companies. In the 24 European Union member states, over 95,000 organizations are public-benefit foundations. Nearly three-fourths of the 54 percent increase in the number of these foundations from 2001 to 2005 can be attributed to European Union enlargement and the rest is a result of an increase in the number of foundations.

43. Bishop and Green (2008) describe philanthrocapitalism as a movement to harness the power of business and the market to the goals of social change. Also see Ben-Artzi (2008).

44. Marten and Witte 2008.

45. Schwab 2008; Maxwell 2008.

46. www.gatesfoundation.org/annual-letter/Documents/2009-bill-gates-annual-letter.pdf.

47. www.macfound.org/site/c.lkLXJ8MQKrH/b.4196225/apps/s/content.asp?ct=6334379.

48. A Note on the Economy at www.hewlett.org/AboutUs/News/A_Note_on_the_Economy.htm.

49. Foundation Center 2008c.

50. Foundation Center 2008a.

51. See Kiess (2008) and World Bank (2009c) for a detailed presentation of innovative financing mechanisms.

52. Not all new funds raised through these mechanisms represent additional financing with regard to conventional ODA.

53. International Energy Agency 2008.

54. United Nations (2008a); World Bank (2008). The forthcoming *World Development Report 2010* will present more complete evaluation of financing requirements and mechanisms.

55. The CDM is the main mechanism for encouraging private investment in mitigation in the context of developing countries.

56. World Bank Institute 2008.

57. Since December 2006 new bilateral funds have been established by Australia, the European Union, Germany, Japan, Spain, and the United Kingdom; see Bird and Peskett (2008).

58. The value of the pledges was $5.7 billion as of exchange rates on January 23, 2009. See World Bank 2009a.

59. Several rules have been adapted to take into account HIPCs' specific circumstances; for example, the policy track record required to qualify for debt relief has been shortened. Additional debt relief has been provided when debt indicators deteriorated because of factors beyond a country's control, such as negative terms-of-trade shocks or natural disasters.

60. Many creditors who have agreed to participate in the initiative are lagging in providing their share of debt relief. Given the voluntary nature of creditor participation in the HIPC Initiative, the IMF and the World Bank will continue to use moral suasion to encourage creditors to participate in the Initiative and to deliver fully their share of HIPC Initiative debt relief.

61. Established in 1989, the DRF aims to help reforming, heavily indebted, IDA-only countries reduce their commercial external debt, as part of a broader debt resolution program. Support from the DRF is provided through grants for the preparation and the implementation of commercial debt reduction operations. The DRF is financed by transfers from IBRD and grant contributions from other donors, as well as investment income earned on such contributions.

62. IMF–World Bank forthcoming.

63. Relates to 20 countries for which the assessment reports have been finalized.

64. The dimensions under the indicator for coordination with macroeconomic policies reveal a sample bias that is likely to unwind with future assessments. A number of the countries in the current sample are part of either the Economic and Monetary Community of Central Africa or the West African Economic and Monetary Union; as such the governments are bound by strict legislation that limits the availability of direct resources from the regional central banks.