A Global Financing Pact for Poor and Vulnerable Countries?

Edited by Matthieu Boussichas
and Patrick Guillaumont

21 Contributions from the Chair in International Architecture of Development Finance to the Summit for a New Global Financing Pact, June 2023

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Foreword

by Philippe Le Houérou

International development financing has faced significant challenges over the past four years due to several global crises, notably the Covid-19 pandemic and the war in Ukraine. These crises have only intensified the difficulties many countries, particularly the poorest and most vulnerable, already face in securing sustainable financing for their development.

These challenges have underscored the urgent need for a major overhaul of the international architecture for financing development. In response, FERDI established a dedicated chair on this subject in 2022, led by a group of independent French-speaking experts known for their extensive experience and their ability to offer clear recommendations, a group that I had the honour and pleasure of chairing.

The group set itself the goal of independently assessing what the global development financing system should evolve into, considering the current international context and lessons learned since the Second World War. Our efforts intensified ahead of the "Summit for a New Global Financing Pact" in Paris in June 2023, where we contributed by organising eight high-level events on key themes within the development finance architecture. This was informed by more than twenty working papers and policy briefs produced throughout 2023, drawing on both the group's expertise and scientific research.

From this work, we have drawn ten key proposals advocating for comprehensive reform of the international development finance system. To share the insights and recommendations that emerged, this book presents a concise version of each document.

The book is structured around these ten proposals, which are grouped into three main categories: reforms to the International Architecture of Development Finance, the mobilisation of new resources, and the allocation of these resources.

The first part of the book highlights the need to restructure the international financing architecture, emphasising the importance of clarifying the various objectives of development financing, identifying overlaps, and ensuring that the focus on global public goods does not overshadow the development needs of poorer countries.

The second part addresses the mobilisation of new resources, focusing on the necessary reforms to attract private finance for development, and the strategic use of in-

ternational taxation—particularly carbon taxes—to achieve a dual benefit for both climate and development.

The final part considers how development resources can be allocated more effectively and fairly, prioritising the poorest and most vulnerable countries, and supporting initiatives that promote agriculture and entrepreneurship in fragile contexts.

I believe the Chair's work has made a valuable contribution to the ongoing debate on how to reform the development finance system to make it more transparent, integrated, and effective. The Paris Summit was an important milestone in this process, which will continue with key events in 2024 and 2025. It is up to the Chair to maintain its contributions beyond this initial phase, with this book marking an important milestone. The second phase of our work will further develop and refine what is summarised here, especially in light of the 4th United Nations Summit on International Financing for Development, scheduled for 2025, ten years after the Addis Ababa Summit.

FERDI's Chair on the International Architecture of Development Finance will continue its work, combining the expertise of leading independent development figures from both the Global South and North with research insights. In doing so, we hope to contribute meaningfully to the reform of sustainable development financing in response to global challenges.

Introduction
Reminder of the 10 Key Proposals

FERDI's contributions to the Paris Summit for a Global Financing Pact*

Patrick Guillaumont

As the Summit approached, there was much speculation about what could be the topic of an international consensus. One thing was certain: the Summit has ignited a flurry of ideas aimed at reforming the global financial system for development. While only few ideas materialized by the end of the Summit, it is hoped that the most robust ones will gain momentum amidst the conflicting and unstable geopolitical interests.

FERDI, through its Chair in the International Architecture of Development Finance, seeked to contribute to this exchange of ideas by addressing crucial issues and formulating proposals. The impact of these contributions are to be assessed beyond the end of the Summit. It is now time to present all the Chair's efforts, which have taken the shape of substantive documents and inclusive events, fostering discussions and refinements. The documents mentioned in this editorial serve as a preliminary outline, representing FERDI's current perspectives on the eve of the Summit. A new book, encompassing new ideas, will be drafted next year.

The document follows the chronological order of the six organized events and is accompanied by ten recommendations that have been forwarded to the Summit organisers. As part of the Summit, FERDI was hosting two significant affiliated side events on June 22. The first event, in collaboration with the Organisation internationale de la Francophonie and the Commonwealth Secretariat, argued that multidimensional vulnerability should be taken into account in the allocation of new financing for development, aligning with one of our primary recommendations. The second event encompassed all our recommendations, with a particular emphasis on four main themes.

* Guillaumont P. (2023) "FERDI's contributions to the Paris Summit for a Global Financing Pact", FERDI Editorial.

FERDI's 10 Proposals in the Lead Up to the Summit for a New Global Financing Pact*

Clermont-Ferrand, 17 May 2023

Organize the New Financing Pact

Proposal 1

• ***Objective:***
Strengthen the transparency of the international development finance architecture, recognize its multiple purposes, going beyond the strict ODA perspective, identify overlapping and inform on possible crowding out of poor countries development by the protection of global public goods.

• ***Modus operandi:***
(i) Implement a standardized financial flows reporting system, that encompasses the major providers, including China, as well as the recipient countries and enlightens multiple purposes;
(ii) this can be done by a deep reform of the OECD's Development Assistance Committee or by the creation of another independent body, possibly inspired by the G20 Common Framework for Debt Treatments.

• ***References:***
- https ://ferdi.fr/publications/financer-des-politiques-mondiales-mais-pourquoi-donc
- https ://ferdi.fr/publications/Juger-de- l'efficacité- des-financements- en-fonction-de-leurs-finalités :-quatre-arbitrages-de- la-coopération-internationale-pour-le-développement

* Chair in International Architecture of Development Finance (2023) "FERDI's 10 Proposals in the Lead Up to the Summit for a New Global Financing Pact".

Proposal 2

• *Objective:*

Tackle the fragmentation of development finance to enhance its effectiveness.

• *Modus operandi:*

(i) Consolidate earmarked funds within host multilateral institutions and integrate there, when possible, independent vertical funds, in particular climate finance funds;

(ii) evaluate their results and enhance their accountability. Ensure that overlapping and inconsistency are avoided through the system of reporting and evaluation, as indicated in Proposal 1.

• *References :*

- https://ferdi.fr/publications/fonds-climatiques-l-heure-du-grand-menage-a-sonne
- https://ferdi.fr/publications/opinion-the-world-bank-should-become-the-imf-of-climate

Proposal 3

• *Objective:*

Ensure the consistency of the various sources of external finance within the national development strategies and with global issues.

• *Modus operandi:*

(i) Implement country platforms that coordinate contributions and promote convergence around core standards, as encouraged by the G20, ensuring that they involve all stakeholders under the leadership of local governments;

(ii) and transform them into regional platforms when the challenges of the policies developed go beyond national borders.

• *Reference:*

- https://ferdi.fr/publications/diversification-et-fragmentation-du-financement-public-du-developpement-rendre-moins-opaque-et-rationaliser-la-structure-eclatee-des-financements-du-developpement

Mobilize Really Additional Resources

Proposal 4

• ***Objective:***
Scale up private finance for development and design public interventions to crowd in the private sector.

• ***Modus operandi:***
Reform the World Bank Group to take the lead on changing the traditional MDB and DFI operating system. Deepen the cooperation among IBRD, IDA, IFC and MIGA. In particular:
(i) based on country private sector diagnostics and strategies, proactively work "upstream" to design and develop bankable projects, especially in poorest countries;
(ii) improve coordination between policy discussions and potential market creation and investments;
(iii) deepen and expand work on development of local financial markets;
(iv) systematically seek private solutions and investments for income-generating projects following a "cascade approach" i.e., along a spectrum of solutions between purely private on one end and purely public investments on the other side of the spectrum;
(v) generalize and coordinate the offer of guarantees to private investors;
(vi) and establish a group-wide joint Key Performance Indicator on private capital mobilization.

• ***Reference:***
- https://ferdi.fr/publications/mustering-the-private-sector-for-development-and-climate-in-the-global-south-is-it-realistic

Proposal 5

• ***Objective:***
Use international carbon taxation to achieve a double climate and development dividend.

• ***Modus operandi:***
(i) Lift the tax exemption on kerosene used by civil aviation for international flights and use the proceeds for the "loss and damage" fund resulting from the COP 27 negotiations;
(ii) such an aviation tax should be calibrated in order to harmonize carbon pricing among various types of fuel and could be extended to international maritime transport in a second step.

- **Reference:**
- https://ferdi.fr/publications/la-taxation-des-carburants-de-l-aviation-civile-comme-source-de-financement-a-destination-des-pays-vulnerables

Proposal 6

- **Objective:**

Design fiscal management strategies to face climate change while avoiding over-indebtedness.

- **Modus operandi:**

(i) Find ways to better include medium and long-run financing constraints, risks and possibly expected investment returns generated by climate change to assess debt sustainability of vulnerable countries;
(ii) promote a widespread use of contingent debt instruments in case of natural disasters to provide rapid and automatic support to vulnerable countries;
(iii) ensure access to exceptional concessional resources for countries facing climate-driven strong exogenous shocks, and efficient private and public creditors' coordination to provide debt relief and avoid debt crises;
(iv) develop new concessional channels to finance mitigation policies in LICs without tapping in existing concessional resources.

- **Reference:**
- https://ferdi.fr/publications/soutenabilite-de-la-dette-et-changement-climatique

Allocate Funds Where they are Needed the Most

Proposal 7

- **Objective:**

Make that concessional development funds be allocated in priority to poor and vulnerable countries.

- **Modus operandi:**

(i) agree to take vulnerability into account in the rules of allocation between countries of concessional resources (and not only in the rules of eligibility to these resources);
(ii) invite the multilateral financial institutions to use an index of vulnerability reflecting the various forms of structural vulnerability in their allocation formulas, rather than create a new category of countries;

(iii) report and assess the actual orientation of concessional flows from each donor according to the poverty and the vulnerability of final recipients, through the system designated in Proposal 1.

• ***References:***
- https://ferdi.fr/publications/financer-des-politiques-mondiales-mais-pour-qui-prendre-en-compte-la-vulnerabilite-des-pays
- https://ferdi.fr/publications/pourquoi-il-n-est-pas-opportun-de-creer-une-categorie-generale-de-pays-vulnerables
- https://ferdi.fr/publications/prendre-en-compte-la-vulnerabilite-dans-la-repartition-mondiale-des-financements-concessionnels

Proposal 8

• ***Objective:***
Build a consensus on a priority support to the sustainable emergence of entrepreneurs in poor and fragile countries.

• ***Modus operandi:***
(i) Help small and medium enterprises along their growth path, by funding a range of tools in target countries, including incubators and business accelerators, pre-investment programs, and sustainable financial vehicles that cover the equity needs of small businesses;
(ii) reform the practice of the DFIs by inscription of this agenda in their mission, and changing their business model so that it takes in account the extra financial impacts of SMEs;
(iii) obtain a global commitment of a coalition of main actors to support this policy by annually granting 400 million USD over ten years for Africa, to implement it; create a large listed fund of funds promoted by the largest donors to attract large private flows into this policy; reform the private sector window (PSW) of the World Bank and the EU blended funds to allow better access and performance.

• ***Reference:***
- https://ferdi.fr/publications/des-millions-pour-des-milliards-accelerer-l-emergence-entrepreneuriale-africaine-pour-une-croissance-acceleree-durable-et-riche-en-emplois

Proposal 9

• ***Objective:***
Reverse under-investment in the agriculture of poor and vulnerable countries.

• ***Modus operandi:***
(i) Enhance land property rights management;
(ii) support investment in local R&D, resilient technologies adapted to local contexts, innovative risk management tools (index insurance, indexed lines of credit), the expansion of irrigation and other forms of water control; building inclusive value chains;
(iii) in particular by setting up a scheme likely to allocate public grants to private investments in agricultural value chains on the basis of their impact and risks.

• ***Reference:***
- https://ferdi.fr/publications/sept-propositions-pour-soutenir-et-financer-le-secteur-agricole-en-afrique-subsaharienne-dans-le-contexte-du-changement-climatique

Proposal 10

• ***Objective:***
Strengthen the effectiveness of budget support by enhancing country ownership.

• ***Modus operandi:***
(i) Request from countries to clarify the consistency between the objectives of their development strategy and their specific policy reforms as well as the investments needed, in particular by systematically comparing public expenditure reviews and poverty assessments (sectoral and geographic mapping);
(ii)promote increased channeling of foreign-sourced funds through the national budgetary system and avoid the multiplication of specialized external agencies;
(iii) promote as far as possible a support based on results, including for the support to mitigation.

• ***Reference:***
- https://ferdi.fr/publications/l-efficacite-du-financement-du-developpement-le-point-de-vue-du-praticien

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Part 1
Organize the New Financing Pact

Proposal 1

Strengthen the transparency of the international development finance architecture, recognize its multiple purposes, going beyond the strict ODA perspective, identify overlapping and inform on possible crowding out of poor countries development by the protection of global public goods.

Financing Global Policies: but Why?*

Jean-Michel Severino, Sylviane Guillaumont Jeanneney

Introduction: Night and Chaos in the Understanding of Global Politics

Our planet is becoming increasingly populated and is facing a growing number of common economic, ecological and security challenges. Recent blows to globalisation have not eliminated any of them.

These common global causes are numerous, evolving and require funding. However, at the start of the third decade of this century, the institutional landscape of international funding for these causes appears fragmented and incoherent. It is the product of the institutional obsolescence of the system inherited from the Second World War, accelerated by the haphazard multiplication of governmental or individual initiatives that are sometimes responding to operational urgencies, sometimes to local political compromises and sometimes to ego movements. The lack of overall reform and rationalisation has led to haphazard public action. This has far-reaching consequences for the effectiveness of policies, including oper-

* Summary of the Working Paper: Severino J.-M., Guillaumont Jeanneney S. (2023) "Financing Global Policies: but Why?", FERDI *Working Paper* P317.

ational contradictions, cost overruns and harmful competition between institutions, all of which create an atmosphere of suspicion and low credibility.

We cannot dream of a global unifying power that would give meaning to collective action. The bi- or unipolar world of the post-war international scene is now considerably more fragmented, despite the emergence of China.

It is thus time to take the collective debate on the organisation of global governance to a new stage. This debate must not only take note of the considerable diversification of global issues but also free itself from the constraints resulting from political division in order to build on what brings people together. Based on the observations made at the turn of the century on development aid and on the experience of twenty years of international negotiations on climate, biodiversity and health, as well as on trade and debt, we need to draw up a clear vision of the goals being pursued by our fragmented international community.

The purpose of this article is to contribute to this debate. The article takes note of the obsolescence of the official development assistance metric that has been the sole thermometer of international public action since the 1960s and proposes a new structure for measuring international public flows. This new structure would make it easier to identify, quantify and assess the impact of these flows.

Our starting point is the observation that international public financial flows now have a threefold objective: to support income convergence between developing and industrialised countries; to ensure a global solidarity base; and to combat global public ills. This leads us to present a sketch of what could be a census of these financial flows according to a new nomenclature that would be collectively accepted by the donors and recipients of the flows and that would take account of the interdependencies and overlaps between these objectives. In conclusion, we will compare this new instrument with the global financing capacity that is available to suggest that our planet does not have a problem of financing capacity for global policies.

Moving Beyond Aid Without Forgetting It: Recognising the Obsolescence of Global Public Policy Measurement

Official development assistance (ODA) consists of states using their taxpayers' resources to provide financial assistance to other, less wealthy independent states through donations, loans and capacity transfers. It really emerged after the Second World War and then developed with the great decolonisation movement of the 1950s and 1960s. It has continued to evolve in terms of its motivations, scope and methods.

This public policy has some remarkable characteristics. It is governed by the Organization for Economic Co-operation and Development (OECD), the United Nations and the Bretton Woods institutions. It has a consensual measurement instrument as well as a mechanism for exchange, evaluation and permanent learning co-administered by the OECD's Development Assistance Committee (DAC) and its administrative division. Objectives of this public policy are common to a large number of countries, and are both qualitative (the Millenium Development Goals [MDGs] and quantitative (the 0.7% of gross domestic product [GDP]).

It is not surprising, therefore, that this strategic, institutional and statistical construct has been the home of practices and measures of flows that are alien to its original concerns: OECD member governments declare ODA transfers that do not strictly correspond to the objectives of fighting international poverty. As a result, a growing number of expenditures of various kinds can be declared, for example, in the area of security. In addition, the measurement tool is becoming increasingly obsolete; a significant proportion of international official flows escape the measurement of ODA, and official development aid flows exceed the amount of ODA as statistically defined by the OECD's DAC. This is because many governments and public bodies that finance developing countries have not joined the DAC. Some public loans that are granted on financial terms below the rate at which the developing country could borrow on the markets do not meet the DAC's criteria for a grant element. Finally, official development assistance now accounts for only a small (and declining) proportion of official financial flows to developing countries.

As a result, the only thermometer for identifying and monitoring international public flows is out of date. However, it remains without competition. This makes it impossible to understand, let alone assess, the performance of the international architecture of public flows, which is undergoing profound change. Reversing this situation means going beyond the historical ODA framework without forgetting it, and positioning a new measurement process on the scale of the entire international policy for financing interdependence between rich and poor countries.

It would be a good idea if reflection on the historical contribution of ODA and the way in which it has been surpassed were not confined to the field of measurement that is the subject of this article, but instead covered all international transfer practices. Numerous new institutions have emerged from shared concerns about health and the environment. For the most part, they borrow their processes and practices from ODA, without always questioning the relevance of this continuity. While ODA is one of the most evaluated public policies in history, it is under challenge. The challenges come first and foremost from developing countries, which denounce (in a partly contradictory way) its inadequacy, its alienating nature and its poor quality, starting with its name, which is considered colonial. Other criticisms include the dictatorship of donors, the failure to listen to recipients and make them accountable, administrative costs and contradictions of substance and fads that are out of touch with reality. But the industrialised countries are also dissatisfied. They criticise corruption and mismanagement in recipient governments. They also question the burden of this policy and would like to see certain countries, especially China, become contributors rather than beneficiaries. All of this deserves to be considered in the design and implementation of new global solidarity policies.

Better Than Aid: From Jungle to French Garden

Today's financial landscape has become a jungle, and the temptation is great to design a new French garden. Let us give in to this temptation for a moment and propose a reorganisation of this landscape.

The new vision we are proposing would be based on the recognition of a plurality of international objectives for flows between developed and developing countries, which in practice are currently illegible in the figures. In the introduction, we set out the three purposes of international public funding, which we believe are now shared and carry a broad consensus. Consequently, we suggest that each country should declare its ODA according to a system that is as standardised as the current ODA system. This would entail declaration of the following:

- Its financial contribution to international income convergence: International Development Finance (IDF)
- Its financial contribution to international solidarity (FIS): In the strict sense of the term, this would include actions to reduce poverty, post-conflict interventions and reconstruction as well as humanitarian crisis management (political or natural).
- Its financial contribution to global public goods (GPG): The international financing of collective goods, with subcategories such as financial stability, adaptation to climate change, mitigation of global warming or carbon transition, biodiversity, health, food, research... the list is non-exhaustive and evolving.

The main aim of this survey of financial flows using a new consensual nomenclature is to take note of the structural changes that have occurred in international collective action and to shed light on the trade-off between the different aims of international policy. The latest arrivals do not eliminate the need for the oldest. While the quest for income convergence—which is undoubtedly THE historic mission of the old 'development aid'—is disappearing from the formal objectives of international public flows, it still continues to be justified. There are ethical reasons for this, or a modern conception of justice based on the promotion of equal international opportunities in the face of the structural handicaps suffered by certain countries. In addition, there is a political need because international inequalities are a factor of international political instability and represent a risk of a trial of legitimacy for world society; all the more so as the countries of South Asia and Africa constitute an increasingly large demographic mass. Since these inequalities are an essential reason for financial transfers between countries, reducing them is also a way of reducing the need for global transfers of global public goods.

In the landscape we have just outlined, contributors and beneficiaries could be different for each defined purpose or sub-purpose. Thus, the famous DAC annex list defining aid recipients and contributors would disappear or would only be valid for the DIF, with corrections to take account of changes in the relative wealth of countries. The justification for the disappearance of this DAC annex list for the financing of public goods is that the differentiation between beneficiaries and contributors to international transfers is no longer a priori between rich and poor countries, but rather between countries that are beneficiaries or victims of a recognised externality (for example, carbon emissions or a pandemic). Each category of purpose could thus have its own set of contributors and beneficiaries and be based on different allocation criteria. The amounts would be allocated on a discretionary basis (as in the old ODA) or would be set by international treaties (as in the case of climate change) according to allocation keys specific to each subject. The substantive objectives would also be different and could range from income considerations (IDF) to common results considerations (for example, 30% of protected areas for biodiversity).

The governance of these global policies should be based on new mechanisms. The United Nations, the Bretton Woods institutions or the various conventions of the parties to international treaties would become (or remain) the main places for determining the objectives of substance as well as financing. But there needs to be a central place for measuring, evaluating and debating organisational practices. We propose that a new body should be responsible for managing this system, with the body set up by the OECD's Development Assistance Committee (DAC) and enlarged to include China and all contributing countries. It would enter into institutional collaboration with the secretariats of the Climate and Biodiversity Conventions, the WHO, the FAO, etc. to establish the criteria for these declarations, which should be validated after consultation with the beneficiary countries. The OECD's DAC, with all its major political, institutional and administrative limitations, remains the most structured and competent body in the world to carry out such a task. The beneficiary countries would be involved in this governance—with transparency as an essential feature—but it nevertheless must be managed in the first instance by the contributors insofar as it is a question of apprehending their contributions.

As is currently the case, this governance body would conduct peer audits, which would be debated on an equal basis, with the dual aim of ensuring the integrity of the declarations and evaluating the system. Unlike at present, these audits would not only involve consultation with the beneficiary countries but would also include them among the 'examiners'. The governance body would also organise debates and learning processes on the standards and practices of international policy.

One merit of the new classification of missions we are proposing would be to allow reflection on the impacts we are seeking. The various Sustainable Development Goals (SDGs) could be divided between the three categories of objectives. New objectives could be identified relating to subjects not currently covered. Geographical targets could also be devised, for example, for climate change. Financial allocations to the Least developed countries (LDC) could be included in both the redistribution funding (SIF) and convergence funding (DIF). In short, the work begun within the OECD at the end of the 1990s to identify the performance of what was then ODA could be taken a stage further by clarifying the results expected from the funding raised.

In fact, the lack of clarification as to what comes under DIF or SIF has profoundly obscured the assessment of public policy. This vagueness allows for shifts between these two objectives: The emergence of one-off humanitarian motives sometimes puts a strain on budgets devoted to structural economic or social objectives. The validity of short-term objectives (for example, the reconstruction of countries) should be combined with a willingness to reduce the volume of funding outside disaster management periods, a practice that is currently impossible to legitimise. This declaratory system could be expected to provide better protection for the most structural policies.

Another improvement that could be expected from the clarification we are proposing concerns the trade-off between support for development (IDF and the financing of global public goods (GPG). This problem affects all subjects, starting with health, but the issue is particularly acute for global warming mitigation financing, which more often than not competes with and complements development financing and, to a lesser extent, biodiversity financing. Financing for adaptation to climate change does not have the same justification as financing for mitigation or support for development. Similarly, the logic of financing for loss and damage, which is a major current issue within the Climate Convention, cannot be equated with that of financing intended to achieve economic growth, even sustainable growth, in a poor country. Clarification of the international community's funding allocations for these issues could be expected to lead to better assessment of both contributions and impacts.

Another example of clarification that is less often mentioned can be found in the subject of financial stability. Financial stability is a common good: Crises are transmitted to the whole planet and are detrimental to growth and poverty reduction in low-income countries. However, financial crises have also justified the introduction of international rules to regulate financial institutions, with the aim of correcting the failings of financial markets marked by asymmetric information, a source of moral hazard, and by their inability to take long-term prospects into account. But the poorest countries are finding it hard to shoulder the burden of these regulations, which means that transfers are needed to build capacity (technical assistance, etc.). Moreover, the introduction of some of these rigorous regulations is restricting the financing of the poorest economies (which particularly results from the considerable increase in compliance requirements in the fight against corruption, terrorism and major trafficking). This also justifies financial compensation and the transfer of skills to the poorest and most fragile countries. Correctly identifying these flows would make it possible to differentiate them from those devoted to economic growth and development.

The new registration and declaration system that we are proposing would make it possible to differentiate between all these issues and to ensure the measurement of funding as well as the collection and analysis of practices devoted to these issues them.

From the French Garden to the English Garden?

The rationalisation we are calling for implies that the various objectives can be clearly separated from each other and that clear trade-offs can be made. The time has come to recognise that this is not the case or at least not to the extent that we might wish. A review of the main trade-offs between the aims of a global public policy shows that it is difficult to rigorously pursue each of them.

Investing in the social sector benefits competitiveness and growth. Investing in productive growth benefits the social sectors. Better management of climate change helps in the fight against poverty. Fighting to preserve biodiversity helps to combat global warming. Adapting helps to green the economy. Therefore, it might seem pointless to try and establish a clear categorisation of objectives to measure contributions to the international common good.

However, the need to set out the objectives, the contributions that meet them and to monitor their achievement is inescapable. One way of reconciling the measurement of these contributions with the overlapping of objectives could consist of a rating system whereby a country's financial contribution could be attributed to a principal objective, a secondary objective and a marginal objective. This would lead to the introduction of a 'Rio markers' type system that would be extended to all the issues of growth, social aid and global public goods.

Take the case of France, which via the Agence Française de Développement (AFD) is to finance a national programme of protected areas in the Sahel to the tune of €20 million. The programme would include reforestation, conservation and economic activity through local green tourism, sustainable agroforestry and social services for local populations in the area concerned. France could declare this 20 million in Objective 1 (primary) as aid for global warming mitigation; in Objective 2 (secondary) as aid for biodiversity; and in Objective 3 (marginal) as socio-economic aid. Weighting coefficients could be added to these declarations.

There are various other solutions to this multiple declaration logic. Each will have its advantages and weaknesses among which we will have to arbitrate. To obtain the total of contributions to public policy, we can only add up the rank 1 contributions. But multi-declaration will give an image of redundancies and cross-logics, a source of learning about double or triple benefits that themselves are encouraged by this mechanism. Thus, we will not be walking through the jungle, but through the famous English garden, which, if it is to be lively and varied, will allow the eye to see all its dimensions without hindrance.

Two main pitfalls of the current system could be avoided in this way: an excessively compassionate view of the needs of low-income countries at the expense of the need for their economies to catch up; and in the face of the climate emergency, giving priority to global warming mitigation projects at the expense of those specifically designed to help low-income countries adapt or simply develop.

The pathways of the renewed declaration system we are proposing would probably be less straight than we might wish. It would be more like an English garden than a French one. But there would be a gain in the inclusiveness and sincerity of the capture and evaluation of flows.

Conclusion

The issues we have just discussed are both wide ranging and complex. They can be the source of potentially massive financial transfers. Wealthy countries may be concerned that this will result in a growing and unbearable financial burden for their taxpayers, and it is also essential to question the relevance of the organisations responsible for implementing these policies.

On the financial front, our message is that fears must be tempered.

Faced with a significant increase in the absolute value of potential funding, the burden of global policies will first and foremost depend on GDP growth in the industrialised countries. For example, the current 211 billion dollars of official development assistance, a very artificial amount and representing a much lower effective budgetary cost, amounts to only about 0.37% of the GDP of all the DAC contributor countries, a category which should be significantly enlarged. This contribution naturally increases with exchanged effort. Thus, the 10% growth in the GDP of these countries alone over five years would represent, at an unchanged burden in relative terms for taxpayers, around 21 billion dollars in new resources for global policies. A general alignment with France's level of contribution at around 0.56% of a projected 2030 GDP would represent a rise to around 351 billion dollars if we take as an example not only France but all the countries that already meet or exceed this ratio, which in practice is almost imperceptible for most OECD taxpayers and entirely bearable.

These figures do not include China. If China were to contribute at the same level as OECD countries and grow at their same rate, this would add 72 billion dollars to current contributions. If its contribution were on a par with France, we would reach around 109 billion dollars. Such amounts are attainable for China. All in all, an 'acceptable' and relatively easy-to-obtain level of global public transfers could be established in about ten years' time at approximately 460 billion dollars compared with the current 211 billion. Thus, it is not especially difficult to finance the famous additional 100 billion dollars for climate or biodiversity. The main issues are legitimacy, fairness in the distribution of funding and the performance of funding rather than that of raising it. This should temper the race for 'innovative financing', although this is legitimate if it is based on scepticism about the ability of 'traditional' contributions to raise additional financing. The question of political will is unavoidable.

From an organisational point of view, it seems to us that we are actually facing greater difficulties.

If we follow the described line of thought, and if it appears that there is a great deal of overlap among the different categories of global public policy issues, then the organisation of global collective action through specialised organisations is a problem; for them, the pursuit of multiple benefits is more difficult than for generalist organisations. The latter mainly have a geographical rationale and are naturally inclined to claim double, triple or quadruple benefit contributions.

From this perspective, bilateral cooperation agencies, generalist United Nation's (UN) agencies, such as the United Nations Development Program (UNDP), and national development banks, have by their very nature a comparative advantage and can claim to manage the problems posed by the focus of international agencies with a specialised purpose related to certain types of objectives.

The regional development banks and the World Bank are in the same situation. In this respect, transforming the World Bank into a climate bank would only be conceivable if we clearly consider that it is not only the climate bank but also the bank for biodiversity, growth, health, etc. In short, that it remains basically what it has been since its birth: a development financial institution that simultaneously supports the national policies of developing countries and the global economy. This point should be clarified: officially entrusting it with the mission of supporting all global policies (alongside the other responsible organisations) by implementing the international conventions of the parties covered by the treaties signed, which is not currently the case, would give the institution a new legitimacy.

But it is also clear that thematic and specialist organisations have undeniable political and technical legitimacy. They also respond to specific mandates that give their funders the illusion that they are dealing with a particular subject with clear and easily assessable results. They can more easily give rise to one-off, limited initiatives. Their size makes it possible to create pragmatic public or public–private coalitions. Their operational performance can sometimes be high. These thematic organisations are unlikely to disappear or stop proliferating.

The juxtaposition of these two categories of generalist and thematic institutions does not prevent the essential task of properly identifying public flows, which is a prerequisite for the very possibility of evaluating policies, but will continue to affect not only the performance of public policies but, in some cases, even prohibit the possibility of evaluating them.

As we can see, the questions of the aims and organisation of the international system are not disconnected: One interferes with the other. However, these considerations do not exhaust the debate on the organisation of the global institutional landscape. Numerous other considerations, such as legitimacy, technical competence, political and financial mobilisation capacity, and a vision of the merits and limits of institutional competition among public players, all play a part in imagining the optimal global public structure.

Classifying, measuring and evaluating is the basis for the long road to structuring global policies in the 21st century, but it is clearly not the end.

Assessing the Effectiveness of Funding According to its Purpose: Four Trade-Offs in International Development Cooperation*

Sylviane Guillaumont Jeanneney

Introduction

International development cooperation has evolved beyond official development assistance (ODA) to include a wider range of public funding and objectives. Its aims fall into three main categories: to provide a minimum of social services necessary to meet everyone's needs in line with the Millennium Development Goals (MDGs) of 2000; to encourage economic convergence between countries, in particular to correct development handicaps; and finally, to promote global public goods, highlighted by the SDGs of 2015, which encompass issues such as climate, biodiversity, health, financial stability and peace. These goods, which are by nature nonexclusive and noncompetitive, benefit everyone without prejudice. The effectiveness of international cooperation must be assessed in the light of all these goals[1].

In pursuing their objectives, donors are faced with four dilemmas: i. the trade-off between economic growth in low-income countries and the immediate well-being of populations; ii. the trade-off between development objectives and the promotion of global public goods; iii. the balance between preventive and curative actions; and iv. the balance between the interests of donor and recipient countries. The effectiveness of global development finance must be assessed in the light of these dilemmas.

* Summary of the Working Paper: Guillaumont Jeanneney S. (2023) "Judging the Effectiveness of Funding According to its Purpose: Four Trade-Offs in International Development Cooperation", FERDI *Working Paper* P327.

1. This text takes up and completes certain developments of Jean-Michel Severino and Sylviane Guillaumont Jeanneney (2023) "Financer les politiques mondiales : mais pourquoi donc ?", FERDI *Working Paper* P317. It benefits from the contributions of many subsequent works by the Chair.

The Trade-off Between 'Development' in Low-Income Countries and the Immediate 'Wellbeing' of the Poor

Income inequalities between developed and developing countries remain significant despite a slight reduction since 2005 in the ratio of gross domestic product (GDP) per capita of the poorest countries to that of the richest. This persistent disparity is accompanied by a tendency on the part of the international community to prioritise aid for social sectors rather than productive sectors. Between 2000 and 2020, the share of development aid allocated to the productive sectors remained relatively low, while assistance in the social and emergency sectors increased, especially in low-income countries[2].

This orientation was influenced by the adoption of the MDGs in 2000, which emphasised the satisfaction of basic vital needs and justified long-term support for education and health. The growing fear of pandemics justifies supporting health systems in poor countries through sustainable transfers. The growing number of natural disasters and the international emotion they arouse have led to an increase in emergency humanitarian aid to the detriment of long-term development actions, which are less often in the headlines. However, the major cause of the disaffection for productive sectors is the conviction that their growth depends primarily on private enterprise and that it is not the role of public policy to subsidise them.

Without vigorous action by the international community to promote growth, there is a risk that inequalities in per capita income between developed and developing countries will increase primarily because of rapid demographic growth in the latter, especially as they are poorer. The situation in Africa is exemplary. Admittedly, the Asian model of growth driven by manufacturing exports is not reproducible in Africa due to the relocation of industrial and agricultural activities in OECD countries, which is linked to environmental constraints. But Africa does present development opportunities based on growth in domestic markets, the exploitation of green resources and advances in digitalisation.

Support for the productive sector comes up against a missing link in the financing of small- and medium-sized enterprises (SMEs), between microcredit for households or very small businesses and financing from local banks or international organisations[3]. Public financial institutions, often guided by criteria of financial return rather than assessment of social and environmental impacts, tend to neglect SMEs. In addition, high transaction costs and a lack of qualified staff to evaluate projects on the ground limit their ability to support fledgling businesses in poor countries. The lack of a risk culture among development finance institu-

2. Cf. World Bank Group. Development Finance (2021) *A changing landscape : trends in official financial flows and the aid architecture*, p.13.
3. Cf. Severino J.-M. (2023) "Des millions pour des milliards : Accélérer l'émergence entrepreneuriale africaine pour une croissance accélérée, durable et riche en emplois", FERDI *Working Paper* P325.

tions leads them to favour middle-income countries to the detriment of low-income countries, which is not optimal because this accelerates development in middle-income countries where there is already a strong entrepreneurial fabric without taking the risk of helping businesses to emerge in low-income countries that have the least.

The Trade-off Between 'Economic Development' and 'Global Public Goods'

It is difficult to know how to divide the financing of development and that of global public goods. This is because there is a lack of clarity about the very scope of global public goods and the measurement of the flows dedicated to them. There is also sometimes complementarity and sometimes competition between the two objectives, which differ according to the nature of the public goods.

Income inequalities among countries are at the root of international migration, disease transmission and insecurity throughout the world. The development of poor countries has positive externalities in terms of the public goods of global health and security. Conversely, the financing of global public goods in low-income economies contributes to their growth. As poor countries are likely to be most affected by rising temperatures, the fight against global warming is beneficial to them in the long term. Nevertheless, there is a short-term trade-off between the objective of preserving global public goods and that of development (or convergence)— a trade-off that differs depending on the type of public good.

The international community's overriding concern about global warming carries with it the risk that spending on mitigation will take precedence over spending specifically on development and adaptation. This fear is all the more acute given that the international community's commitment at the fifteenth session of the Conference of the Parties (in 2009) to devote $100 billion a year by 2020 to 'climate finance', which was to be additional to development funding, seems to have been forgotten. The abandonment of the additionality principle is clearly reflected in the OECD's accounting of climate funds[4]. It refers to the extent to which public funds intended for developing countries include a more or less pronounced climate objective, but it does not say whether taking account of the climate objective has been accompanied by an increase in public financial flows; in other words, whether climate funds do or do not partly replace development aid.

4. The explicit aim is to see how far we are from the $100 billion target. Cf. OECD (2022) *Financement climatique fourni et mobilisé par les pays développés en 2016-2020. Enseignements tirés d'une analyse désagrégée*, OECD Publishing, Paris, 87 p.

Within climate financing, the trade-off between credits for mitigation and credits for adaptation is also critical. We are a long way from the 50% earmarked for adaptation at the same Conference. The predominance of mitigation investments can be explained by the conditions under which they are financed. Since they are mainly destined for emerging countries, they can be financed at or close to market conditions; conversely, adaptation investments are mainly located in poor countries and require a high degree of liberalisation. The creation of a new fund to compensate the most vulnerable countries for the loss and damage caused by climate change, to which there was agreement in 2022 at the Conference of the Parties in Sharm El-Sheikh, is probably not the best response even if it does have the merit of recognising that the industrialised countries are historically the main culprits of global warming, which is an affirmation of an essential principle of international justice. Relying on compensation creates a moral hazard that endangers risk prevention through adaptation measures.

Protecting biodiversity or eradicating pandemics poses the same problem of trade-offs with development projects. The trade-off between financial stability and economic development is less problematic. As financial crises in developing countries risk being transmitted to other countries, the financial stability of developing countries is a global public good, but at the same time, a condition for their growth. Responsibility for this lies with the IMF, whose interventions are increasingly flexible and better calibrated to the needs of low-income countries, even if this support still suffers from shortcomings that merit consideration by the donor community.

Finally, one of the most difficult trade-offs is between security and development objectives. While the international community has become aware of the importance of internal security and the fight against all forms of extremism for local development, the funding of security expenditure is hampered by the Development Assistance Committee (DAC) rule that such expenditure can only very marginally be counted as ODA. The trade-off here is currently to the detriment of the public good of security for all.

The Trade-off Between Preventing and Repairing Damage

In managing public policies, governments are faced with a difficult choice between preventive and curative actions, and they are often tempted to favour immediate interventions over long-term strategies due to uncertainty and budgetary constraints. This tendency is evident in the allocation of public funds, with humanitarian aid and social assistance often favoured over investment in sustainable development. One proposal to counter this preference for the short term is to base the allocation of development funds, particularly from multilateral development banks, on the structural vulnerability of countries in addition to the existing criteria of allocation formulas, such as GDP per capita and the quality of economic policy. The aim is to target lasting obstacles to economic growth.

The trade-off between immediacy and long-term vision also applies to the financing of public goods, with different implications depending on their nature. For example, investing in conflict prevention—admittedly costly in the short term—would be economically advantageous in the long term despite the challenges posed by the complexity of the risk factors and the need to combine rapid and structural interventions to demonstrate the benefits to the populations concerned.

In terms of financial stability, the IMF's interventions illustrate a more successful balance between prevention and correction, integrating structural reforms to ensure a sustainable balance in public finances and balances of payments while offering technical assistance to improve the management of public finances.

Mitigation efforts in the climate area are naturally part of a preventive approach aimed at anticipating and limiting the future impacts of climate change. However, the trade-off between prevention and correction becomes more complex for adaptation measures, especially in the agricultural sector in which the aim is not only to compensate for losses due to climatic events but also to promote a structural transformation of agriculture towards more resilient practices that require long-term investment in research, irrigation and the development of agricultural value chains.

Balancing the Interests of Developing Countries and of the International Community

The academic literature on the motivations for aid has highlighted that geopolitical considerations and the self-interest of donors may be dominant. During the Cold War, Western aid was at least partly aimed at preventing developing countries from joining the Communist camp. This motivation disappeared with the fall of the Berlin Wall, followed by a temporary reduction in international aid. However, the events of 11 September 2001 heightened awareness of the interdependence of all countries and was exacerbated by global climate, health, financial and security challenges, leading to the adoption of the MDGs in 2015 aimed at promoting universal values, such as human rights and respect for the environment. At present, political considerations remain important, with aid still conceived by the contributing countries as an instrument for projecting power or, at the very least, influence.

Numerous academic studies have sought to disentangle the aims of development aid from those that respond to the recipient country's own interests or to the commercial concerns of the donor. To this end, they generally estimate an econometric relationship between the proportion of aid going to each country and the characteristics of that country—such as population size, per capita income or historical and cultural links—which are supposed to reflect the interests of the donors as well as the interests of the recipient. These studies reveal just how difficult and often artificial it is to pit the interests of donors against the needs of recipients, as if in the end, the two were antagonistic by nature. The main issue is whether the purposes corresponding to the interests of the country of origin of the financial flow are illegitimate.

In some blatant cases, the interests of donors may appear to take precedence over those of the recipient. One way of approaching this question is to examine the geographical destination of aid flows in the light of the main criteria likely to represent the needs of recipient countries. A renewed analysis of the selectivity of aid seeks to understand whether aid is directed towards the countries that need it most according to objective criteria, including poverty, size and vulnerability in its economic, climatic and sociopolitical dimensions, that determine their needs as well as other features reflecting a common interest between donor and recipient, such as geographical proximity or sharing the same language and culture.

Finally, aid conditionality, which imposes requirements on recipient countries, has been criticised for being ineffective and intruding on national sovereignty, while at the same time, favouring the commercial interests of donors. The 2005 Paris Conference on Aid Effectiveness called for greater alignment of aid objectives with the priorities of recipient countries, but old habits die hard[5]. The trade-off between the development interests of the countries receiving aid and the interests of the international community, which according to the economic literature, appeared to be relatively artificial, is now taking on new relevance with climate finance.

5. Cf. below: "What Should Be Done about Conditionality?", Matthieu Boussichas, Patrick Guillaumont, Sylviane Guillaumont Jeanneney

Conclusion

The presence of these four dilemmas in the international policy of financing the developing countries justifies entrusting an international institution with the task of identifying the objectives pursued by donors[6]. Even if there are overlaps between the various objectives, a clear vision of the goals pursued by each is the first condition for arbitration to be carried out in a reasoned and consensual manner and for the overall effectiveness of funding to be ensured.

6. Cf. above: "Financing Global Policies: but Why?", Jean-Michel Severino, Sylviane Guillaumont Jeanneney

Proposal 2

Tackle the fragmentation of development finance to enhance its effectiveness.

Before Setting Up New Climate Funds, Consolidate Existing Ones*

Philippe Le Houérou

Today there are at least 81 active climate funds and it is unclear how much they commit and disburse, to whom, for what purpose, and with which impact. Given the urgency of scaling up climate change mitigation and adaptation projects in emerging markets, rationalizing and redefining the current messy climate aid architecture is a crucial step for the development community to take.

An Opaque Climate Fund Landscape

At least 94 climate funds have been established since 1991. The Global Environment Facility was the first in 1991 and the most recent is the Climate Finance Partnership Fund. Thirteen of these 94 climate funds have "disappeared" due to formal termination and/or lack of recent information or evidence of an active website. This leaves an estimated 81 climate funds active today.

According to a recent consolidation of available data, the multiplication of climate funds peaked during the 2006-2014 period, and the trend picked up again in 2021-22. Of the 81 active funds, 62 are multilateral funds — with 50 housed in multilateral development banks, bilateral agencies, or in United Nations agencies, while the remaining 12 are standalone — and 11 are bilateral funds (eight are housed in bilateral aid agencies with the remaining three standalone). In total, 73 of these funds are partially or entirely financed by public monies. The remaining eight are private.

* Text originally published on **Devex.com**, 31 March 2023 : Le Houérou P. (2023) "Opinion: Before Setting Up New Climate Funds, Consolidate Existing Ones", Devex. Online : https://www.devex.com/news/opinion-before-setting-up-new-climate-funds-consolidate-existing-ones-105186 – according to FERDI *Working Paper* P320 (see following note).

As for whose responsibility it is to undertake this consolidation and push for climate funding efficiency… traditional development assistance donors should spearhead the process.

Unfortunately, few answers exist on such basic questions as to what the budget, financial flows, allocation, and impact of this wide and diverse universe of climate funds are — this information is simply not available to the public. The difficulty in aggregating annual fund commitments and disbursements arises from the fact that the 81 fund websites have vastly different standards regarding public reporting.

The answers we can give are indirect, limited, and sadly disappointing. In 2019-20, the annual average of the estimated disbursements of the 62 publicly funded multilateral climate funds were $4 billion according to the Climate Policy Initiative and $3.1 billion according to the 2022 "Report of the Standing Committee on Finance."

This compares with the average annual disbursement flows financed with the in-house resources of multilateral development finance institutions and of multilateral development banks in 2019-20. According to CPI, the multilateral DFIs disbursed $68 billion on climate projects and, according to the SCF, the MDBs disbursed $38.3 billion on climate projects and programs.

This would mean that the disbursements of multilateral climate funds represent only 5.8% of the climate disbursements of multilateral DFIs, and 8% of the MDBs disbursements.

A Lose-Lose System for Donors and the Recipients of These Funds

While each new fund may have been set up with a strong rationale when taken individually, when looked at as a system, the plethora of funds has not yet produced the necessary results at scale and may never do so. There is simply no architect to ensure the efficiency, effectiveness, and impact of the climate funds system. As a result, the multiplication of climate funds has added to an already badly fragmented aid architecture as it evolved over the last 30-40 years.

Hard questions need to be asked about the knowledge generated by the system of these funds and how it is shared, given the lack of the most basic information, and of any independent body to evaluate, curate, and disseminate the learnings being generated. As a result, successful good practices and possible innovations of this system of 73 publicly financed entities with no common definitions, standards and oversight, cannot be scaled up.

In addition to being suboptimal for the efficient allocation of global taxpayers' monies, the fragmentation of the climate funds system is a tax on capacity for recipients' governments and/or private sector entities.

Fragile countries are often ravaged by climate change yet face obstacles in accessing climate finance because of mountains of bureaucracy built into these financing mechanisms.

This capacity tax is a hidden but very real and heavy burden on recipients' governments that must deal with hundreds of aid institutions and financing channels with their own rules and procedures. This cost of aid fragmentation is well documented, and it is the heaviest for lowest-income countries where administrative and implementation capacity is generally weak.

How to Reset

Despite the lack of evidence around value for money and impact of the current climate funds system, new funds are being contemplated, such as a "loss and damage" fund. Before adding to an already fragmented system, it is urgent to improve transparency, harmonize the reporting and impact measurement standards, and drastically consolidate the existing climate funds landscape.

This consolidation can start with the 62 multilateral, official donors' financed climate funds, and can be grouped or rationalized in many ways, for example:

- By hosting institutions (MDBs, the U.N.).
- Along key specific functional specializations (e.g., mitigation, adaptation, biodiversity).
- By geographies (global or regional).
- By type of recipient executing agencies involved (public or private).
- By financial instruments (technical assistance, loans, equity, grants, guarantees).
- Or even be grouped by a combination of the above.

For the surviving consolidated funds, harmonizing definitions and standards, setting up transparent reporting requirements on financial flows and results, as well as improving knowledge management should be a prerequisite before setting up new multilateral donor-funded climate funds.

As for whose responsibility it is to undertake this consolidation and push for climate funding efficiency, we believe that at the very least, the traditional development assistance donors should spearhead the process. The Organisation for Economic Co-operation and Development's Development Assistance Committee members, for example, should try to improve parts of the existing system that is under their purview.

The inconvenient truth is that it is politically easier to create yet another climate fund to show that "we are doing something," rather than making the painstaking effort to ensure efficiency and effectiveness and build on lessons learned from the past 30 years.

But given the urgency, climate finance should be an obvious candidate for rationalization within the bigger aid architecture, and one that ultimately benefits development assistance donors and recipients alike.

The World Bank Should Become the 'IMF of Climate'*

Rabah Arezki, Philippe Le Houérou

The latest Intergovernmental Panel on Climate Change report raises grave concerns that countries are falling behind their commitments to cut greenhouse gas emissions. The window to make required changes is worrisomely narrowing. Climate stability, like global macrofinancial stability, is public goods. Yet, while the International Monetary Fund has an operational mandate to preserve global macrofinancial stability, the U.N. Framework Convention on Climate Change only sets out the basic legal framework and principles for international climate change cooperation. It doesn't pair the operational mandate on climate stability with a global institution. The World Bank could be that very institution.

The United Nations, through the Conference of the Parties, has nurtured the historical Paris Agreement on climate change adopted in 2015, covering climate change mitigation, adaptation, and finance. Rather than imposing top-down targets, the bottom-up structure has allowed countries to choose nationally determined contributions, or NDCs. The Paris Agreement also has a provision for a "global stocktake" every five years. The U.N. now needs to designate a "super implementer" working closely with the secretariat of the UNFCCC.

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Why the World Bank?

Rather than waiting for another desperate warning from the IPCC, the U.N. should entrust the World Bank Group, an intergovernmental organization that is part of the U.N. system, with a clear mandate to monitor countries' commitment to cut GHGs and accelerate the energy transition of the global economy.

Critics would argue that the bank's governance structure weights donor countries' control proportionally, which is fundamentally different from that of the U.N. Yet, that move to entrust the bank alongside the UNFCCC secretariat would give further impetus to the bank's shareholders to boost lending toward climate stability. This move would combine the bottom-up approach of the Paris Agreement toward NDCs championed by the U.N. with the world of development finance championed by the World Bank.

In addition to its obvious financing capacity, the bank is well equipped to take on a renewed mission to achieve climate stability. First, the bank has a universal membership, which spans globally—its original loan was to France following the devastation of World War II. That universal membership could come in handy to help monitor the NDCs to curb GHGs.

Second, the bank has built vast expertise in policies, knowledge, and investments spanning all climate-relevant sectors like energy, transport, water, agriculture, construction, manufacturing, mining… as well as social sectors. It is helping some member countries to design their national plans to combat climate change including by producing new country climate diagnostics.

Third, the bank has also built expertise through private sector investment directly through the International Finance Corporation (IFC) and indirectly through advising governments on policies to foster and catalyze private sector investments.
The IMF mandate provides a template for redefining the bank's mandate. In other words, the bank should become the "IMF of climate." The template provided by article IV of the IMF's Articles of Agreements is particularly relevant for the bank's proposed new mission. According to article IV, IMF's

member countries have an obligation “to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates.”

Specifically, members should avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members. In practice, IMF’s regular monitoring of economies and provision of policy advice goes much beyond exchange rate issues, allowing it to identify weaknesses that could lead to financial and economic instability.

The World Bank could play the same monitoring and policy advice role for international climate change cooperation. In the context of these consultations, the bank should monitor policies toward achieving climate stability, in turn complementing the regular inventories countries submit to the UNFCCC and the review process under the Paris Agreement for implementation of NDCs.

Green Funds and Finance

Economists have put forth carbon pricing as a solution to address climate change to account for the negative externality associated with the use of fossil fuels—and in turn, shape consumers’ and investors’ behavior. But navigating the transition is complex and attention has shifted toward distributional issues. Evidence also suggests that citizens are not ready to pay more for energy during the transition, at least in the short run. The backlash against fuel subsidies reforms in low- and middle-income countries and against “carbon taxes” in advanced countries, including the yellow vests movement in France, is telling.

The bank is well equipped to help support policies for climate stability including carbon pricing with an appropriate design of schemes to address distributional issues. More broadly, the bank’s technical expertise should be mobilized to foster the acceptability of bold climate actions with mechanisms to compensate losers within and between countries.

To do so, the World Bank should coordinate the ever-growing funds aimed at combating climate change but whose actions have become fragmented; and work closely with U.N.-backed funds, such as the Adaptation Fund, Global Environment Facility, and Green Climate Fund. The bank should also strengthen its existing partnerships not only with the U.N. and IMF, but also with regional development banks, bilateral aid agencies, and NGOs that are actively involved in climate and green finance.

The biggest GHG emitters—the United States, China, and the European Union—should show the way and commit to undergoing surveillance on their commitments to reduce GHG emissions. That would encourage other World Bank member countries to do the same. Whether or not they borrow from the bank, under that new mandate, member countries would be enjoined to collaborate with the bank on how to amend their policies and limit the effects of their climate policies on countries most directly affected, such as island nations.

The World Bank is in a unique position to document individual countries' environmental policies through its consultations with member countries on an annual basis, just like the IMF article IV consultations. The bank could produce an annual update on "national climate action" in consultation with individual countries' authorities, to share with all member countries.

The Private Sector

The World Bank could integrate its financing capacity and efforts to foster the private sector directly and indirectly in the context of these consultations. Besides carbon pricing, appropriate regulations and standards could help promote private sector solutions as well as encourage technological innovation and transfer to combat climate change.

The bank has championed the agenda to mobilize development finance to maximize finance for development. It should now focus its policy recommendations and development interventions more squarely on climate-related investments. For example, it should scale up the use of guarantees toward projects that will allow countries to ignite the necessary private sector investments needed to accelerate their transition toward renewable energies.

The bank played a key role in launching and building the world's green bond market. Going forward, the bank should use its expertise to further green, nature, and blue bond markets, and impact investing tailored to the investment needs of different countries to combat climate change.

Standards

Last and not least, to avoid "greenwashing" the bank should be at the center of introducing international standards and data disclosure to facilitate its function of climate surveillance and to help promote transparency, which has been a point of contention in the UNFCCC negotiations. The World Bank should curate climate standards under the UNFCCC, in turn providing an anchorage to monitor progress toward reducing emissions.

All in all, the proposal for a renewed mission for the World Bank that we are putting forward today should help rekindle much-needed multilateralism by bridging the gap between the world of development finance with that of international climate policy to save humanity from the existential threat posed by climate change.

Proposal 3

Ensure the consistency of the various sources of external finance within the national development strategies and with global issues.

Diversification and Fragmentation of Public Funding for Development and Global Public Goods

Reducing the Opacity and Rationalising the Fragmented Structure of Development Financing*

Alain Le Roy, Jean-Michel Severino

The Fragmentation of Public Funding for Development

Official Development Assistance (ODA), expressed in constant dollars, has increased from €80 billion in 2000 to €210 billion in 2020, with growth not only noted in bilateral and multilateral aid but also in multi-bilateral aid. Multi-bilateral aid, which was negligible until the 2000s, now accounts for over 15% of total aid flows. Bilateral aid has grown less rapidly, leading to a decline in its relative share.

This expansion of aid is accompanied by increasing fragmentation due to the growing number of donors, intermediaries and agencies. The number of bilateral donors has increased from 25 to 43, with a multiplication of agencies from 145 to 411. Multilateral donors have experienced a similar trend, with the number of entities doubling from 46 to 91 (World Bank, 2021).

In 2019, the total number of bilateral and multilateral donors reached 502, with a decrease in the average amount of public donations from $1.5 million to $0.8 million. The increase in the number of donors can be unevenly seen at the level of recipient countries: whereas in 2009, 22 countries were involved with more than 80 agencies at any one time and 12 countries with fewer than 20, while in 2019, 92 countries were involved with more than 80 agencies at any one time and only one with fewer than 20.

* Summary of the Working Paper: Le Roy A. & Severino J.-M. (2023) " Diversification and fragmentation of public financing for development. Reducing the opacity and rationalising the fragmented structure of development financing", FERDI *Working Paper* P321.

Adding to the complexity of fragmentation, particularly in climate financing, private funding accounts for almost one-third of the donors identified.

What are the Reasons for this Fragmentation?

International development finance is characterised by fragmentation due to the growing diversity of its missions, institutions, models and beneficiaries. This proliferation of players is often explained by the need to solve new problems, leading to the creation of additional funds or institutions. The complexity of adapting existing funds can also lead to the parallel creation of new entities. The persistence of obsolete funds, which are politically difficult to close, contributes to the fragmentation of the system; the existence of such funds is encouraged by the specific characteristics of international funding, which is far removed from the beneficiaries and subject to distant contributors. Accountability biased in favour of contributors and the complexity of governance influenced by geopolitical considerations also reinforce this tendency, thereby compromising the effectiveness of the system.

Is this Fragmentation Synonymous with Inefficiency?

The increasing fragmentation of funding for international development and for global public goods raises crucial questions about its effectiveness. There is a general perception that the system may be inconsistent, with conflicting missions between institutions that may be inefficient, with similar missions being carried out in disparate ways by different institutions and with administrative costs that are excessive in relation to the volumes involved.

Studies show that fragmentation is associated with lower economic growth and a deterioration in the quality of bureaucracies in recipient countries, especially when their institutions are initially weak.

However, fragmentation can also have advantages, which include encouraging the specialisation of funds, healthy competition among donors and stimulating innovation. Recipient countries can increase their bargaining power despite higher negotiation costs. Extreme centralisation is no guarantee of greater efficiency, and moderate fragmentation could offer advantages by taking into account the diversity of governance models, conceptions of social justice, emulation between institutions and the broadening of funding sources.

Choices must be guided by well-defined criteria and evaluated according to the advantages and disadvantages specific to each context by integrating economic, technical and philosophical perspectives.

In line with the summit on vulnerable countries and climate change, the allocation of multi-bilateral ODA seems to take greater account of the vulnerability of recipient countries than bilateral and multilateral ODA.

Does the State of the Art Allow Us to Envisage Credible Avenues for Greater Coherence and Rationalisation?

The suboptimal effectiveness of public development funding raises fundamental questions about the need for greater coherence and rationalisation. The text explores various ways of responding to these challenges. They can be grouped into four categories.

1. Reducing the number of funds: Reducing the number of funds is presented as the most radical solution for combating fragmentation, although its implementation is complex. The text suggests encouraging the abolition of old, obsolete funds and limiting the creation of new funds before better rationalisation. Technical difficulties include the identification of relevant funds, the distinction between collecting and operational funds and the need to ensure that the abolition of funds does not result in an overall loss of support. The merging of existing funds is also mentioned, but this may encounter obstacles in negotiations between donors.

2. Improving transparency: Efforts to improve transparency, particularly in multilateral institutions, are highlighted. Reforms since 2010 have been particularly aimed to standardise aid accounting systems between donor countries (security spending, cost of refugees, accounting for loans, debt relief, etc.). Initiatives such as IATI (International Aid Transparency Initiative) and Publish What You Fund should also be mentioned. The idea of an analysis grid has been put forward, which would be applicable to all types of funds to ensure transparency based on various criteria. The OECD could be asked to take part in drawing up this grid. A clause to reassess the relevance of new institutions after ten years has also been suggested.

3. Reforms affecting multilateral institutions: the United Nations' (UN) Delivering as One initiative, although ambitious in its objectives, has not fully met expectations. Its aim was to rationalise UN agencies through four elements: a lead agency, a common programme, a shared budget and a single office in each country. However, the independent evaluation showed mixed results, with inequalities in the implementation of the elements from one country to another. Wider issues are being raised, such as the need to redefine the roles of multilateral institutions, the relationship between the UN and multilateral development banks and the designation of a sector leader to set priorities and standards.

4. Coordination of stakeholders: This objective has been the subject of numerous international initiatives, such as the major UN conferences on climate change and biodiversity and the Universal Health Coverage 2030 (UHC2030) in the field of health. It has also led to the creation of various regional and national platforms for coordinating stakeholders (country platforms). A key factor in the success of these initiatives is to give recipient countries decision-making power and not to contradict the major international options. The article mentions the limitations of current dialogues on aid effectiveness, such as the Global Partnership for Effective Development (GPEDC) and the Development Cooperation Forum (DCF), highlighting their weaknesses despite commendable attempts.

In conclusion, the reform of the financing for development architecture must ensure that the various interventions are integrated into the objectives defined by the most legitimate bodies. The challenges remain immense, ranging from reducing fragmentation to effectively coordinating the various players and redefining the roles of the multilateral institutions. Imperatives for the success of these reforms encompass consideration of the multidimensional vulnerability of recipient countries and preservation of their ownership in the use of funds.

In Conclusion: Towards a Forum for Analysing Development Financing

It is unlikely that there will be a comprehensive and harmonious reform of international governance due to the increasing complexity of global issues, divergent viewpoints, international conflicts and gaps in the governance of donor and recipient countries. In the face of these challenges, new international institutions and processes will continue to emerge, and efforts will be made to resolve problems through mechanisms of convergence, coordination and institutional rationalisation.

It is more realistic to seek a reasonable combination of contradictions, accepting a system that may be moderately dysfunctional but perceived as fair by beneficiaries and contributors. This ongoing assessment should be carried out by a body separate from the political decision-making bodies on a model comparable to the

Conseil d'orientation des retraites[7] in France, which would produce shared analyses and encourage open debate.

This ideal body would bring together contributor and beneficiary countries, third-party players, such as foundations, NGOs and civil society, and the private sector. It would be supported by a secretariat comprising its own resources, academic contributors and development institutions. The aim would be to reach consensus on the state of the system, identify possible changes and assess the costs and benefits.

The remit of this body would include the ongoing production of analyses of flows and institutions, the evaluation of the system's performance, the development of accountability frameworks and an international transparency charter, and the identification of inconsistencies. Although all the work would be public, the body would not formulate political proposals, merely presenting alternative scenarios. Political decisions would remain the responsibility of the various stakeholders.

The creation of this body raises dilemmas, and there are three potential avenues: an extension of the mandate of the OECD's Development Assistance Committee, a location within the United Nations, or an anchoring within the G20. Each of these options has advantages and disadvantages, and the ideal solution remains complex to determine.

Reference

• **World Bank** (2021) *A Changing Landscape: Trends in Official Financial Flows and the Aid Architecture*, Washington D. C., World Bank Group—Development Finance.

7. This can be translated as "Pensions Policy Council"

Part 2
Mobilize Really Additional Resources

Proposal 4

Scale up private finance for development and design public interventions to crowd in the private sector.

An IFC/World Bank Group Experiment in Mustering the Private Sector for Development*

Philippe Le Houérou, Hans Peter Lankes

Private financial flows to Emerging Markets and Developing Economies (EMDEs) today are lower than in 2015, when both the UN's Addis Ababa Agenda for Action and the Paris Agreement were adopted - committing the world to financing the SDGs and reducing carbon emissions. Were the expectations simply unrealistic? How can we hope to measure up to the challenge of our generation?

In the run-up to this week's Paris Summit for a New Global Financing Pact, we wrote about the obstacles to achieving these goals and detailed a real-life experiment launched in 2016 at the IFC/World Bank Group that aimed at achieving the necessary change at scale ("IFC3.0 – Creating Markets")—by moving the institutions from a reactive to a pro-active stance combining their sovereign and private instruments to grow private investment. The strategy had the strong backing of shareholders (indeed, it was the basis for IFC's historic capital increase in 2018); the main challenge was the internal culture at both IFC and the World Bank.

* Le Houérou P., Lankes H. P. (2023) "An IFC/World Bank Group experiment in mustering the private sector for development", FERDI *Policy Brief* B252.

There were six core elements:

First, integrated World Bank Group private sector diagnostics and strategies. It is important to understand where the opportunities and the obstacles are and what needs to happen, and then to forge agreement across the World Bank Group to deploy the most impactful public and private sector instruments. 48 country private sector diagnostics and 61 country strategies had been prepared by March 2023. At the core were a series of "If-Then" scenarios that connected investment potential to government and World Bank Group action. The crucial task is ensuring that these diagnostics and strategies are designed in collaboration across the World Bank Group. There has been modest progress but ideally, the WBG Country Partnership Frameworks (CPFs) would be replaced by more operational, detailed business plans that include the detailed IFC country strategies.

Second, enforcing the "Cascade". This is basically a principle of subsidiarity—the World Bank Group should give preference to private sector solutions where feasible and appropriate, for instance SME credit lines or power generation, and preserve its public lending firepower for situations which require a public approach. A prime example was the Queen Alia airport in Amman, Jordan, which moved from an IBRD-supported public sector concept to a successful, IFC-led private model. In in-between type situations, private approaches might require public support, for instance policy dialogue, guarantees or blended finance to de-risk investments. To systematically implement the Cascade, World Bank staff incentives should be changed (developing alternatives to public-debt-creating lending volume targets); for loans financing income generating public investments, there should be mandatory justification in board documents why a private solution is not possible.

Third, developing local capital markets. A large share of the global investment challenge will have to be financed domestically. IFC and the World Bank launched a joint capital markets development program (J-CAP), so far running in a dozen countries, that combines advice for policy-makers and regulators with transaction support – such as anchoring transactions in mortgage markets, bond issues or stock exchanges. An example was the creation of a mortgage refinancing market in the CFA Franc Zone. Beyond the J-Cap, IFC is proactively creating green bond markets with a mix of specific advisory services and the purchase of new issuances by banks in EMDEs. To scale up, in 2018, IFC and asset manager Amundi, launched the Amundi Planet Emerging Green One fund (AP EGO) to stimulate demand for green bonds in emerging markets.

Fourth, "creating projects". The lack of bankable projects and of local capacity (or foreign interest) to develop them has long been recognized as a key impediment. Our scaled-up finance will chase the same small number of projects unless we have a massive, hands-on approach to project development. IFC 3.0 needed to add entrepreneurial and project developer talents to the existing pool of financiers—staff working 'upstream' of investments to create opportunities and prepare feasibility studies. For instance, IFC teams are working to accelerate the transition to electric buses in emerging market cities such as Cali, Colombia, Lviv, Ukraine, and Ho Chi Minh City, Vietnam. In a little over two years, 250 new staff have added some $30 billion in potential investment pipeline. This was and remains a profound transformation of the IFC DNA. And it is a cost that other DFIs can free-ride on: there is a need for a DFI system-wide solution.

Fifth, de-risking investments where appropriate. Risk, both perceived and real, is a key barrier to greater foreign finance and investment. With its partial risk guarantees (PRG) and MIGA, the World Bank Group has powerful instruments to mitigate investor risk, especially in infrastructure. As mentioned above, these are a core part of the Cascade: private and guarantee solutions should be the default, sovereign loans should require justification. But unfortunately, guarantees continue to be extremely rare and the trend is down. This, despite internal and external independent assessments over the last three decades emphasizing the value of these instruments and calling for a big step up. There is a need for proactive management, for a change in incentives and for new skills. Separately—partly to fill the guarantee-void—the IDA Private Sector Window (PSW) was set up in 2017 to de-risk IFC and MIGA investments in the poorest countries through concessional blending, for instance, by mitigating local currency risk. The PSW's mobilization performance could be improved, but it remains a crucial instrument.

And sixth, measuring impact systematically. To strengthen its focus on development but also to help connect strategy to projects, it was key for IFC to create a measurement system that could (1) anticipate, ex-ante, the development impact of its operations, and (2) capture not only project impact but also the broader influence investments would have on the market or country. IFC launched the Anticipated Impact Measurement and Monitoring (AIMM) framework in 2017. AIMM inspired the impact frameworks of several other development finance institutions and enabled IFC to develop the Operating Principles for Impact Management, an anti-impact-washing initiative launched in 2019 and now managed by the Global Impact Investor Network (GIIN).

Complete the job

As the leading multilateral development institution, with the ability to offer public and private solutions and an unparalleled level of knowledge, the World Bank Group should take the lead on scaling development finance from billions to trillions. IFC 3.0 has been a multiyear experiment which should be exploited to see what worked, what didn't, and why. In our opinion, there is progress but also a need to double down on implementation. The private sector side of the WBG, i.e., IFC and MIGA, must continue to shift from a reactive to a proactive approach to 'creating markets' and project development; and the public side, i.e., IBRD and IDA, must act in a complementary manner, embracing the private sector as a key development agent.

International Regulation and Financial Inclusion

Between Dead-End and Renouncement*

Christophe Angely

Banking services have existed since Sumerian times[8], initially based on highly subjective assessments of the risks involved. The resulting selection process relied on risk measurement tools which, for a long time, were based on analyses carried out by bankers with access to privileged information[9]. However, with the industrial revolution, a more objective approach to credit risk developed. The Great Crash of 1929 marked the start[10] of a new era with increasing regulation of banking activities on a national and global scale to better manage the systemic risks arising from this approach.

Banking Sector Regulations on Credit Risk and AML/CFT

This lasted until the 1970s when the banking sector underwent a significant evolution with the introduction of sophisticated models for assessing the risk of default, whether for individuals[11] or companies[12], triggering the beginnings of a

* Angely C. (2023) "International Regulation and financial Inclusion: Between Dead-End and Renouncement", FERDI *Policy Brief* B255.

8. Like the Code of Hammurabi, an example of a loan with interest (Babylon 1555 BC)
9. This highly selective approach was at the origin of the popular old saying "banks only lend to the rich and powerful"
10. The *Glass-Steagall Act* is another name for the 1933 *Banking Act* in the United States which establishes :
    1. the incompatibility between commercial banking and investment banking ;
    2. the federal system for insuring bank deposits ;
    3. the cap on interest rates on bank deposits (Regulation Q).
11. Fair Isaac was founded in 1956 as one of the first analysis companies offering credit evaluation services to individuals in the United States. Its well-known FICO score (ranging from 300 to 850) is used as a key decision-making tool by financial institutions, insurers, public utility companies and employers.
12. The first corporate credit rating models go back to the late 1960s with Edward Altman developing his well-known Z-score model for default prediction, which is still used today in Bloomberg reports as a default risk benchmark.

financial deregulation phase, first in the United States and then spreading to the developed economies. To counterbalance this tendency and fight systemic risks, the Basel Committee on Banking Supervision (BCBS) was created in 1974, laying the foundations for the future Basel I, II, III and now IV agreements. Regulated banks, notably the global ones, were required to adopt adequate tools to measure and monitor risks, in particular the risk of borrower default, and were subject to sanctions if they failed to meet this requirement.

But the globalisation of the financial sector also required that banking infrastructures be capable of safely managing information and transaction flows, with the support of international payment systems and specialised networks such as SWIFT[13] and SEPA[14]. To insure it, cross-border activities and trade flows between different jurisdictions experienced an increased level of scrutiny. This banking activity, based on bilateral agreements between institutions and also called Correspondent banking, plays a crucial role in facilitating international transactions[15].

It is strictly monitored and supervised because of its exposure to the risks of money laundering and the financing of terrorism (AML/CFT). The institutions involved must comply with the standards set by the FATF, which aims to standardise AML/CFT practices worldwide and recommends that banks rigorously monitor and manage these risks.

On both accounts, these regulatory developments reflect a growing awareness of the challenges posed by financial globalisation and the need for international cooperation to maintain the integrity and stability of the global banking system.

The Financial Crisis of 2007/2008 Changed it all

The global financial crisis of 2007/2008, triggered by the subprime mortgage crisis in the United States, revealed the limits of the financial deregulation policies adopted since the 1970s. The spread of the crisis via derivative products and markets, and the underestimation of sovereign credit risk in Europe, exacerbated

13. Thanks to the SWIFT network, a global provider of secure financial messaging, it is possible to make transfers in foreign currencies (outside the SEPA zone) throughout the world. In short, SWIFT is the main global messaging system used by banks and financial institutions.
14. With the SEPA network, it is possible to make credit transfers, in euros only, within the European Union; however, the SEPA network also covers the United Kingdom, the four countries of the European Free Trade Association (Iceland, Norway, Liechtenstein and Switzerland), as well as four micro-States (Andorra, Monaco, San Marino and the Vatican).
15. It is also worth noting that, on multiple occasions, the failure of this essential link accelerated major financial crises. For example, it was through this chain that the 1930/1933 crisis, which led to the Great Depression of the 1930s, spread. The initial panic was triggered by the collapse of a correspondent bank in Nashville (Tennessee), leading to the de facto suspension of all payments for around a hundred institutions. The contagion effect then spread like wildfire and the network of correspondents finally collapsed..

its impact. To secure the financial system integrity new regulations have been adopted in the United States[16] and the implementation of the Basel III recommendations, jointly with stricter accounting rules[17] has been accelerated, underlining the importance of applying rigorous methods to assess and protect against the risk of default. At the same time, penalties have been increased for institutions suspected of being too lax in their AML/CFT procedures.

However, these measures have also had an impact on financial inclusion, particularly in the areas of correspondent banking and credit analysis. The repressive nature of these responses[18] has made financial institutions more reluctant to take risks, in certain regions and for certain customer segments.

Correspondent Banking and "De-Risking"

This arrangement, based on a bilateral agreement, requires the Correspondent bank to have a direct business relationship with the customer of the Respondent bank. It facilitates payments for and between banks[19]. This mechanism has long existed in various forms, such as the Hawala, Hundi and Fei-chen. It is vital to the global economy and is now mainly the preserve of very large financial institutions.

Correspondent Banking Affected by the 2008 Crisis

Since the 2008 financial crisis, despite an increase in the overall number of banks, the correspondent banking sector has seen a 20% decline in the number of correspondent institutions between 2011 and 2018.

This global phenomenon is having a negative impact on the development of SMEs, domestic banks, trade and project finance[20] players and all international clearing activities.

16. The Dodd-Frank Wall Street Reform and Consumer Protection Act was an Act of Congress passed by the US Congress in 2010. It is the main legislative component of the reform of the financial market launched during Barack Obama's presidency in the wake of the subprime crisis. *"An Act to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail", to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."*
17. Following the 2008 financial crisis, the IASB, in cooperation with the FASB, launched a project to address the weaknesses of IAS 39 and US GAAP, the internationally recognised standards for the accounting of financial assets and liabilities in annual financial statements since 2001. In July 2014, the IASB finalised and published its new IFRS 9 methodology, which applies to financial organisations in Europe, the Middle East, Asia, Africa, Oceania and the Americas (excluding the US).
18. Which hit the French bank BNP Paribas in 2014 with a record fine of US$ 8.9 billion and the British bank HSBC in 2013 a fine of US$ 1.9 billion. In both cases, the fines were imposed for actions considered to be money laundering.
19. It is essential for remittance transfers and for foreign currency transactions between exporters and importers
20. Trade Finance covers the specific tools used to finance a commercial transaction between two companies, while Project Finance covers the tools used to finance a project.

How Can We Explain this Decline?

Post 2008, regulators tightened measures against money laundering and terrorist financing (AML/CFT), imposing harsher penalties on institutions deemed to be negligent[21]. This reaction led the banking sector to adapt its internal structures, increasing the costs of acquiring and monitoring customers[22]. But the complexity and subjectivity of rules deemed "too open to interpretation by the regulator" have prompted some banks to withdraw from correspondent banking altogether, in some cases cutting commercial and historical ties or pulling out of certain regions altogether. This so called "de-risking" phenomenon prompted the FATF in 2015 to clarify its guidelines in an attempt to mitigate the undesirable impacts of this trend[23].

What Dynamics Are We Really Facing?

Managing the risks associated with money laundering and the financing of terrorism (AML/CFT) requires a rigorous analysis and monitoring of customers following the KYC procedures[24]. However, despite genuine efforts at clarification, the constant evolution of the rules and their interpretable nature encourage financial institutions to be overly cautious. And the extraterritorial nature of sanctions, particularly from the US authorities, is accentuating this attitude in key corridors to and from the US dollar and the euro, where the number of players is falling sharply. Faced with these risks, banks have developed adaptive strategies on several levels, limiting transactions whose intrinsic profitability is low given the capital they use[25] and the nature of the associated risks, and even withdrawing completely from certain business relationships in jurisdictions deemed too risky.

Disproportionate but Poorly Measured Impact on the African Continent

The decline in the number of correspondent banks since the 2008 financial crisis has had a disproportionate effect on Africa, exacerbating the challenges of access to financial services and economic inclusion. According to BIS figures, in 2017 around 30% of the world's population still did not have access to payment services, but this was often more than half the population in some African countries (a continent where only 7 countries have a banking penetration rate of more than 60%).

21. Cf Footnote 11
22. These costs have not stabilised and have continued to rise directly or indirectly in recent years.
23. This attitude is dramatically illustrated by Barclays' decision in May 2013 to abruptly sever its correspondent banking relationship with Dahabshiil, the main organisation for transferring remittances between Somalia and the UK.
24. Or, according to the interpretation of the recommendations of the American authorities, a KYCC, Know your customer's customer...
25. Notably those characterised by high volumes of transactions but relatively low returns and often high capital consumption (due to stricter prudential standards following the 2008 crisis).

The arrival or accelerated growth of substitute pan-African players has not solved the fundamental problem of access to hard currency transactions, which is notably crucial to the commodities trade and remittance services to migrants that predominate in Africa. De-risking is a serious problem for the international community, in the words of the FATF, "*which can lead to financial exclusion in certain regions or countries, less transparency of flows and, potentially, greater vulnerability to the initial risks of money laundering and the financing of terrorism*".

Alternative solutions, in particular the use of letters of credit[26], are being explored, mainly using international banks, most often American. But alternative solutions often result from choices made by private entities whose primary objective is fiduciary in nature. Unsurprisingly, the richer corridors are being perpetuated, while those serving poorer countries or jurisdictions, or those perceived as more unstable, are being abandoned or are incurring dissuasive operating costs.

This situation has direct implications for financial inclusion and long-term economic development, particularly in African countries. International financial institutions, such as the World Bank and the IMF[27], note that in this phase of concentration, the redirection of migrant remittance flows to other players is accompanied by an increase in transaction costs and an impoverishment in the number and quality of services on offer (thus triggering even more concentration!).

Ironically, efforts to strengthen the security of the global financial system and to better protect individuals ultimately have a direct impact on the most vulnerable countries and populations, whose momentum towards financial inclusion has certainly been slowed. More worryingly, this dynamic could encourage the use of informal networks, which are less transparent and more likely to evade AML/CFT control measures.

In conclusion, the decline in correspondent banking represents a major challenge for Africa, requiring attention and coordinated action at international level to support financial inclusion and economic development, while maintaining the integrity and security of the global financial system.

26. A letter of credit is an agreement issued by a bank, in which the bank agrees to guarantee payment on behalf of the buyer, if the conditions of the agreement between buyer and seller are met. A letter of credit is also known as a documentary credit.
27. In 2017, in a case study, the IMF highlighted the effects of this contraction on Fiji, Tonga and Vanuatu. Together with the World Bank, it points to the geographically specific nature of these effects, particularly in the Caribbean, the small countries of Europe and Central Asia, the Pacific Islands and, of course, the African continent. Liberia, for example, saw the number of its correspondent institutions halved (from 75 to 36 between 2013 and 2016), as did Sudan, where the contraction took place between 2012 and 2015.

Credit risk in developing countries

Fintechs – Established Players

Over the last two decades, Fintechs, whose development and growth are linked to the Internet and its disintermediation capabilities, have profoundly changed the banking sector. They have particularly shone in the area of online lending, reducing transaction costs and improving the quality and speed of service. The development of Fintechs has been stimulated by the promise of reduced transaction costs linked to technological innovations, at a time when, since 2008, traditional banks have been weighed down by growing overheads linked to stricter regulatory requirements.

While Fintechs were innovating with new credit assessment methods using artificial intelligence and machine learning, traditional lenders were becoming more cautious as the rules tightened. Peer-to-peer (P2P) lending platforms emerged as credible alternatives, prepared to take on risk on the basis of their own credit analysis models, offering solutions to borrowers previously excluded from the traditional banking system.

Changing Regulatory Regimes for Fintechs Can Help or Hinder the Development of the Sector

Regulatory developments are having a crucial impact on the FinTech sector, particularly in the area of P2P. The UK stands out for its adoption of regulatory sandboxes[28], an initiative successfully tested for M-PESA in Kenya. This regulatory flexibility is essential if Fintechs are to compete with traditional banks, which have historically benefited from asymmetric information based on historical customer relationships.

Regulators, recognising their potential for greater financial inclusion, have gradually worked to level the playing field between banks and Fintechs. The European Union, with its revised Payment Services Directive (PSD2), wants to open up the market to new players by ensuring that payment service providers do not block or hinder account information services and the use of payment initiation for their customers.

Yet while the number of Fintechs has grown rapidly post-2008, the volumes processed remain limited. In the UK[29], although the P2P lending market has grown significantly, the stock of loans represented only 0.4% of the total market in 2015.

28. These are systems for testing and supporting new financial services or business models in real-life conditions; they are subject to special, often lighter, oversight and supervision.
29. Zopa, first P2P, launched in 2005.

Nevertheless, the impact on SME lending is notable, with P2P platforms accounting for almost 5% of total lending in the country and 12.6% of SME lending in 2015, demonstrating the potential of Fintechs to redefine the financial landscape.

Credit in Developing Countries: the Case of Sub-Saharan Africa

The specific characteristics of developing countries, particularly in sub-Saharan Africa, pose challenges for credit analysis. Credit rating systems, standardised on the basis of norms designed for developed economies, rely on data and models that are poorly adapted to local contexts, creating barriers to accurate credit risk assessment and limiting access to financing. In these economies dominated by the informal sector, conventional data collection is costly and complex, making it difficult to offer credit and increasing the cost of capital.

P2P platforms are emerging as solutions, by reducing information asymmetry through the collection of digital data, but the impact of these innovations remains limited by physical infrastructures that are still underdeveloped and overly restricted access to digital services in many African regions. In sub-Saharan Africa, credit remains inaccessible to a large part of the population, but also to SMEs[30], with credit penetration rates significantly lower than in other developing regions of the world. The success of models such as M-Pesa in Kenya, while remarkable, remains the exception rather than the norm.

However, microfinance institutions (MFIs) and banks, the traditional players, have no choice but to also invest in digital solutions to adapt to the development of Fintechs, which are proving their real potential for transformation, even if their activities remain mainly focused on cross-border payments and credit to individuals.

This situation reflects the complexity of promoting financial inclusion and economic development in sub-Saharan Africa, where the expansion of credit services, even for digital businesses, is hampered by underdeveloped basic infrastructure and access to digital services.

30. In 2016, the FSDK under the aegis of the World Bank and the Central Bank of Kenya estimated that loans to Kenyan SMEs accounted for 25% to 30% of the total loan portfolio of the Kenyan banks surveyed. By way of comparison, in 2013, in East Africa, the percentage for Kenya was just under 23%, but compared favourably with 17% in Rwanda, 14% in Tanzania and 8% in South Africa. In the same year, in Nigeria, West Africa's largest economy, SME lending was less than 5% of the total loan portfolio.

To conclude

Dead-end

The European Banking Association (EBA) warned against de-risking practices in March 2021, stressing that "*compliance with anti-money laundering and countering the financing of terrorism (AML/CFT) obligations under EU legislation does not oblige financial institutions to refuse or terminate business relationships with entire categories of customers*". Indeed, this approach can unfairly exclude customers[31] from the financial system with serious consequences for financial inclusion, particularly for cross-border payments in developing countries. The IMF, in its 2017 report, highlighted the negative impact of de-risking on growth in vulnerable countries.

Yet despite its importance, this subject remains little explored in development studies, certainly due to a lack of data, but perhaps also because it is politically sensitive in most developed countries. It is this observation that the development community should seize upon to break what appears to be a deadlock. Solutions, such as the use of blockchain or the use of public entities as does the possible role of the IMF in supporting remittance payment chains, remain to be explored.

But most of these proposals do not even address the financing of SMEs, even if the literature is long on why it is essential to economic development and employment.

The Wrong Direction

The emergence of fintechs in developed countries may have given the impression that they were immediately available solutions to the challenges facing developing countries, particularly in Africa. Hopes were high for SMEs. However, obstacles (inadequate infrastructure, regulatory framework, data security, etc.) considerably limit their usefulness.

Despite an increase in the range of services on offer and wider customer coverage, fintechs do not offer a credible solution to the lack of credit available to SMEs, or seem only able to do so by working with traditional financial institutions.

The Right Direction

Fintechs have revolutionised credit risk analysis by developing alternative models based on a wider range of data, moving away from traditional analysis methods based solely on financial data. This field of innovation has had a significant impact, especially in Africa, where it has stimulated the growth of the individual credit sector and influenced banks to integrate more data specialists into their

31. Adding that "*customers may find themselves deprived of access to the financial system. De-risking can be a legitimate risk management tool in some cases, but it can also be a sign of ineffective management of money laundering and terrorist financing risks, which can have serious consequences*".

teams of analysts. To meet the very specific needs of African SMEs, it is now essential to explore new models combining traditional financial data and alternative data (behavioural data, remote sensing data, non-financial corporate data...) to assess the risk of default. These potentially sector-specific models would then require a tailor-made regulatory approach that diverges from the globalised norm, providing an opportunity for African regulators to promote financial inclusion and economic development. The establishment of regulatory sandboxes could facilitate experimentation with these new models.

The international community will then have to decide whether or not to support this move, which will inevitably have an impact on developed countries and their own banking industry.

Proposal 5

Use international carbon taxation to achieve a double climate and development dividend.

Taxation of Civil Aviation Fuels as a Source of Financing for Vulnerable Countries*

Alou Adessé Dama, Vianney Dequiedt,
Audrey-Anne de Ubeda, Grégoire Rota-Graziosi

At the end of COP27 held in Egypt in November 2022, 196 countries agreed to create a fund dedicated to the loss and damage caused in countries affected by climate disruption. Shortly afterwards, President Macron announced the organization of an international summit in Paris in June 2023, aimed at proposing a new financing pact with vulnerable countries, facilitating their access to the financing needed to deal with the consequences of both recent and future crises. The Landau Report (2004) had already considered environmental taxes on air and maritime transport, sectors that are totally exempt and not covered by the Kyoto Protocol, as two potential sources of revenue to be considered for financing human development and achieving the Millennium Development Goals. Nearly 20 years later, the alignment of climate and development issues makes the introduction of taxes on jet fuel and/or maritime transport doubly relevant, allowing the mobilization of resources in the short term in the framework of this new financing pact and generating long-term effects favour of decarbonisation.

Air Transport and CO2 Emissions

Since the 1940s, aviation has experienced rapid growth, largely led and influenced by the United States. The Chicago Convention, signed in 1944 by 52 countries, and the International Air Transport Association (IATA) laid the foundations for international cooperation in civil aviation. Today, demand for air transport is concentrated in wealthier countries. According to Gössling and Humpe (2020), in 2018, the passenger-per-capita ratio was 3% for low-income countries, 15% for middle-income countries and 202% for high-income countries. Upstream of

* Summary of the Working Paper: Dama A. A., Dequiedt V., de Ubeda A.-A., Rota-Graziosi G. (2023) " Taxation of Civil Aviation Fuels as a Source of Financing for Vulnerable Countries", FERDI *Working Paper* P318.

the air transport value chain, jet fuel production is an activity dominated by a few countries and companies. In 2019 and 2020, 16 countries accounted for 75% of global production, and the top 4 producers (United States, China, South Korea and India) alone accounted for 50% of global production. According to Lee et al (2021), civil aviation emissions amounted to 1 billion tonnes of CO_2 in 2018. These emissions represent 2.4% of anthropogenic emissions and continue to rise despite technological progress. The United States accounts for almost 30% of total emissions, and US domestic flights alone account for 20% of total emissions. The top 10 countries account for 70% of emissions, and international flights account for 54% of total emissions.

Tax Treatment of Jet Fuel

Most countries levy taxes on petroleum products, including jet fuel for domestic flights, in the form of specific or ad valorem excise duties. Paraffin used for international flights is generally exempt from all duties and taxes. This absence of taxation is the result of a long evolution of international relations in civil aviation initiated by the Chicago Convention in 1944. It authorized the taxation of fuels by the country where it is loaded into the tanks and avoided double taxation by prohibiting countries where the aircraft landed from taxing the fuels still in the tanks. The exemption of jet fuel consumed on international flights is the result of bilateral agreements.

According to OECD data, the average effective pricing is €9.6/tonne CO_2 in 2021, compared with €79.6/tonne CO_2 for diesel and €71.2/tonne CO_2 for petrol. In the G20 countries, average effective taxation is €8.9/tonne, €78.7/tonne for diesel and €67.3/tonne for petrol. This very significant difference in average pricing between jet fuel and other fuels is the result of two phenomena: firstly, the more favourable tax treatment of jet fuel compared with other fuels when used for domestic flights, and secondly, the tax exemptions applicable to jet fuel used for international flights.

A tax on jet fuel would reduce this gap, which significantly alters price signals and distorts public and private incentives for financing, promoting or using transport modes. In addition to its environmental dimension, this gap is particularly unfair because air transport remains a service consumed mainly by the richest households in the richest countries, despite the recent development of so-called low-cost airlines (Büchs, 2021).

Potential and Effects of a Jet Fuel Tax

A tax on jet fuel could generate substantial revenue, from €6 billion with an excise duty on jet fuel consumed by international flights of €0.1/litre to almost €20 billion with a rate of €0.33/litre. Given the concentration of air transport activity, most of this revenue would be collected by a few countries, including the United States, China and Canada. EU Member States would account for just over 9.5% of total revenues. A rate of €0.33/litre is consistent with the EU's commitments to decarbonize economic activity, while a rate of €0.1/litre is a minimal scenario, far from the levels of CO2 pricing sought by the European Union, but which would probably meet with less reluctance from the United States, since it is the level of tax already applied by certain American states. The estimate does not take into account the impact of the tax on the behavior of airlines and the growth in air traffic, estimated at 4% over the next twenty years, according to Boeing and Airbus.

The introduction of a tax on jet fuel for international flights would have an effect on the price of this fuel, which represents around 25% of the price of tickets sold by airlines and a larger proportion of their costs. This tax would increase the price of airline tickets from 2.7% for a tax of €0.1/litre to 9.2% for a tax of €0.33/litre, assuming a price elasticity equal to -1 (i.e. the assumption that a 1% increase in ticket prices would lead to a 1% reduction in the consumption of international flights). These estimates assume a fiscal impact of 100% of the tax on the price of jet fuel and the complete transmission of this increase in the price of jet fuel to the ticket price. Assuming a fall in air traffic with a price elasticity equal to -1, the estimated tax revenue would be €5.8 billion for a tax of €0.1/litre. In the scenario of a tax adopted worldwide and set at €0.33/litre, a level corresponding to a CO2 price of around €130/tonne, the revenue collected on the consumption of jet fuel for international flights is estimated at €18 billion a year. The United States would be the main tax collector, accounting for 34% of the revenue generated. If China, Canada, Russia, India, Japan and Brazil were included, these seven countries would account for more than 70% of revenues. The European Union would account for almost 10% of total revenue.

Taxing jet fuel on international flights could have other re-allocative and incentive effects, such as encouraging airlines to use more fuel-efficient aircraft and to adopt sustainable fuels. Taxation could also encourage airlines to make greater use of fuel tankering, which consists of taking on board more fuel than necessary for the flight in countries where the price of fuel is lower. These substantial changes in behaviour, which would be expected if a tax were introduced but are difficult to assess, would have a negative impact on tax revenues but a positive effect on air transport related CO_2 emissions.

Implementing the Tax: Legal Constraints, Political Opportunity and Technical Implementation

The 1944 Chicago Convention on International Civil Aviation is often seen as a legal constraint on the introduction of taxation on jet fuel used for international flights. However, this text does not prohibit the taxation of jet fuel, it merely specifies an exemption from duties and taxes on the fuel contained in the tanks at the time of landing of an international flight. There is nothing, for example, to prevent countries that have already adopted taxation on their domestic flights, such as Brazil, the United States, Japan, Norway and the Netherlands, from signing bilateral agreements to tax international flights between them. The exemption of jet fuel consumed on international flights is an intrinsic result of bilateral agreements signed between States and not of the Chicago Convention. In the case of the United States, a major player in the sector, these agreements are only binding on the federal government, leaving the American states free to tax jet fuel regardless of the nature of the flight. At European level, the application of a de minimis rule would make it possible to levy a tax on fuel consumed on intra-European flights (Faber and O'Leary, 2018).

In 2019, a group of EU countries responsible for more than 50% of the emissions produced by the European aviation sector invited the European Commission to re-examine and take forward the debate on the taxation of civil aviation. Recognising that tax exemption for international aviation is no longer appropriate in the face of today's climate challenges, the EU is paving the way in a proposal for a directive known as "RED III", in 2023, to tax jet fuel for intra-European flights in order to reduce CO_2 emissions, with a gradual alignment on road transport taxation within 10 years. France, which adopted a solidarity tax on airline tickets in 2005 to finance the international organization Unitaid, is in favour of this tax, but would like to favor a European approach. Whatever the scale considered - European or global - the implementation of a jet fuel will require broad political support, which could be encouraged by the dual challenge of mobilizing resources for vulnerable countries and combating climate change. Unanimous and rapid adoption of such a tax on a global scale seems unlikely. Nevertheless, given the concentration of the sector, the adoption of a tax by a small group of countries could prove sufficient to capture a large proportion of air transport.

The choice of the generating event as well as the choice of the stage at which the tax is payable throughout the life cycle of jet fuel (production, import, storage, delivery to airlines) are decisive for the success of revenue collection. Implementing a tax on jet fuel does not raise any major technical difficulties because the civil aviation sector is highly concentrated. It involves a limited number of players at certain levels of the value chain, such as jet fuel producers and aircraft manufacturers. Although there are more airlines and airports in absolute terms, their respective markets are highly concentrated around a few players. Jet fuel producers,which are the major oil companies, are already taxed on most of their production, without this posing any particular difficulties in terms of implementation and control. An alternative approach to the tax would be a charge for environmental services rendered by the atmosphere. Whichever approach is chosen, the mechanism for allocating the proceeds of the tax to a fund for vulnerable countries will need to be specified and clearly defined.

Conclusion

The tax exemption for jet fuel consumed on international flights today appears to be a budgetary and environmental anomaly. This exemption is the product of a multitude of bilateral agreements governing air traffic between countries, rather than a principle established by the Chicago Convention. It is comparable to a tax expenditure because it is based on a deliberate national policy.

A €0.33/litre tax on jet fuel consumed on international flights would raise €18 billion a year, while a €0.1/litre tax would raise €5.8 billion a year. This tax would reduce the carbon pricing differential currently enjoyed by air transport. It would be particularly fair in view of the profile of the passengers concerned. Finally, it would also provide an incentive to decarbonise the sector by favoring sustainable fuels and the most efficient aircraft. It would thus complement the initiative to make the sector carbon neutral by 2050: CORSIA (Carbon Offsetting and Reduction Scheme for International Aviation), a very ambitious initiative adopted in 2020 by the International Civil Aviation Organization (ICAO), which ignores the fiscal instrument and relies on a voluntary approach that will be largely insufficient for effective decarbonisation.

The highly concentrated structure of the sector considerably simplifies the collection of this tax, whether it is payable at the jet fuel refining, storage or delivery stage. The main difficulty is political. In the absence of global coordination, which would be the best solution, the support of a few countries including the United States, the European Union, Japan, China, India and Brazil would be sufficient to capture almost three quarters of the sector's CO_2 emissions. The monopolistic competition characterizing the sector would limit the damaging effects in terms of competitiveness of the unilateral adoption of such a tax. However, further analysis is still required.

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Proposal 6

Design fiscal management strategies to face climate change while avoiding over-indebtedness.

Debt Sustainability and Climate Change*

Bruno Cabrillac, Camille Fabre, Luc Jacolin

Climate change has both immediate and long-term consequences on the debt trajectories of developing countries. Their high physical vulnerability to global warming and the increase in natural disasters, combined with lower socio-economic resilience (food and agricultural insecurity, high population growth, lack of social safety nets and political instability), are putting a strain on public finances at a time when they already have little budgetary leeway.

In addition, financing the energy transition represents a major financial challenge for the sustainable development of these countries. According to UNECA, African countries will need to invest around $500 billion in the energy transition by 2030. The need to adapt to climate change is both more immediate and greater in relative terms than in developed countries. For African countries, the financing needs to adapt to climate change are estimated at $438 billion by 2030 (Songwe *et al.*, 2022). Thus the financing needs associated with the fight against climate change represent an essential component of the financing requirements necessary for sustainable development.

At the same time, climate change is weighing on the investment and debt capacity of developing countries. Losses in economic growth caused by climate change (De Bandt *et al.*, 2022) may limit their ability to raise fiscal and borrowing resources. As early as 2015, Standard and Poor's warned of the risk of massive deterioration in the creditworthiness of vulnerable countries (Kraemer *et al.*, 2015) and rating agencies have begun to take climate vulnerability into account. Klusak *et al.* (2021) estimate that if emissions were to remain at a high level[32] consistent with a temperature rise of 5°, 63 countries would see their sovereign ratings downgraded by just over one notch, on average. Rising climate risks are putting upward pressure on the cost of market financing (e.g., in the form of climate risk premiums) on the order of 65-120 basis points (Geneva 25 : Climate and Debt, 2022) for the most vulnerable countries.

* Cabrillac B., Fabre C., Jacolin L. (2023) "Debt Sustainability and Climate Change", FERDI *Policy Brief* B249.

32. *Representative Concentration Pathways* 8.5, compatible with a 5° increase in temperature.

This scissor effect, between rising financing needs on the one hand and lower financing available at a higher cost on the other, risks triggering a vicious circle for the most vulnerable countries, paralysing their adaptation efforts and delaying their climate transition, particularly energy transition. The international financial community is naturally concerned by this issue, which is at the crossroads of the management of two global public goods: sustainable development and the fight against climate change. In fact, multilateral financing tools dedicated to combating climate change and mitigating the financial impact of natural disasters have been progressively put in place (CMAF Report, 2019, pp. 33-41), including the establishment in 2022 of the *IMF's Resilience and Sustainability Trust* and associated financing facilities.

However, the scarcity of ODA resources in relation to the scale of the needs means that financial engineering solutions are being sought to leverage this type of funding. With regard to the prevention of debt crises caused by natural disasters, a first avenue that can be explored is that of insurance or contingent instruments. These instruments make it possible to transfer part of the risk to creditors or insurers, with ODA possibly covering part of the cost of this transfer. Another way to avoid a vicious circle between climate and financial vulnerability could be to take adaptation efforts into account when assessing the net risk of natural disasters. Finally, debt/climate swaps can also be a solution, particularly in the context of debt restructuring operations. Apart from this, their comparative advantage over direct financing remains limited (Quentin *et al.*, 2022).

Can the same instruments be used to address the risk of the transition to net zero,[33] particularly in terms of energy? This risk is even more difficult to assess than the physical risk, at least for low-income countries and Africa, which only emit a small share of greenhouse gas emissions (3% in the case of Africa). This is because the time horizon for their commitments is further away than the 2050 carbon neutrality commitments of the advanced countries included in the Paris Agreement, and the degree of risk associated with failing to meet these commitments is also difficult to assess. However, it might seem logical to take transition efforts into account when assessing sovereign risk, if we consider that the delay in transition investments weighs on potential long-term growth. But this reasoning undoubtedly applies to many public investments with a high economic return and underpins the balance sheet approach (net debt of public assets) supported in particular by China (I. Ball *et al.*, 2021).

33. Transition risk is the risk of not being on track to meet its emission reduction commitments. In this case, the country may be forced by foreign pressure (border carbon tax, conditionality of aid, diplomatic actions, etc.) to take brutal measures that weigh on production.

The Question of the Sustainability of Public Debt in Light of Climate Change

The question of the sustainability of public debt in light of climate change is a central issue for low-income countries, which raises several questions:

• The first is how to take proper account of the reduction in sovereign risk engendered by climate policies. Increasing vulnerability to physical risks due to climate change makes it a key factor in sovereign risk assessment. It is therefore logical to consider only the net risk in debt sustainability analyses, taking adaptation efforts into account, provided that indicators are available to measure the actual impact of these investments. Thus, for example, an investment in irrigation reduces the risk of drought. This is a powerful incentive for both the donor and the beneficiary to invest in adaptation.

• The same reasoning can be applied to the climate transition risk defined as the additional cost associated with a transition that is too late, too limited or, on the contrary, too abrupt. Assessing this risk and therefore mitigating it is also difficult. The first risk is that of stranded assets. While it is appropriate to try to assess this risk, for example in the case of fossil energy resources, it will be less obvious to assess its mitigation through diversification policies. Another risk that is more difficult to measure is the risk of not meeting emission reduction commitments. The extent of this risk depends crucially on pressure from the international community (climate conditionality, carbon tax at borders, etc.).

• Should we go so far as to no longer take into account the net financial debt, but the net debt of public assets contributing to climate policies? The answer lies in an old and more general debate on a balance sheet approach to public debt, from which public assets are deducted. This approach, advocated by Larry Summers for example, is based on a logic of economic return on public investment (i.e., in terms of growth), which is often verified for advanced countries (A. Abiad *et al.*, 2015). In addition to the fact that the growth efficiency of public capital is more uncertain in low-income countries, due both to problems of investment quality and multiple bottlenecks in the development process, this approach does not necessarily guarantee debt sustainability. On the one hand, in LICs, sovereign debt is largely external and in foreign currency and growth does not necessarily generate more external revenue. On the other hand, the capacity of governments to transform growth into tax revenue is less and also uncertain (see for exemple H. Ahir *et al.*, 2021). Moreover, the implementation of development strategies based on the accumulation of public capital was largely a failure at the end of the last century, resulting in a severe debt crisis. Yet international initiatives to promote infrastructure investment in developing countries have proliferated, including the recent G7-led *Partnership for Global Infrastructure and Investment*, the European Union's *Global Gateway* strategy and China's *Belt and Road Initiative (BRI)*. The fact that many of the countries that have benefited from the BIS are over-indebted or have even defaulted on their debts raises the question of the relevance of this strategy.

• Extrapolating from this, we can ask the question of whether all assets, including natural and human capital, should be taken into account. This approach is facilitated by the work carried out under the coordination of the World Bank, which aims to provide an exhaustive inventory of a country's capital (The Changing Wealth of Nations 2021). Compared to the previous approach, this approach has the advantage of taking into account changes in natural capital (and therefore in environmental policies, including biodiversity, as well as the depreciation of fossil assets), but also in human capital and therefore in education policies. This would meet the wishes of Nature Finance, which advocates (Integrating Nature into Debt Sustainability Analysis). The link with long-term growth could be less tenuous than in the case of physical assets alone, even if the link with medium-term repayment capacity remains problematic. However, the Changing Wealth of Nations approach shows that SSA is the only region in the world that has lost wealth over the last two decades. It is probably no coincidence that it is also the region with the most episodes of balance of payments and/or debt crises.

• Whatever the scope of the assets taken into account when assessing solvency, the question arises of how to account for the investments contributing to these assets (i.e., a forward-looking approach to the solvency standard). In this case, it is no longer a question of assessing the denominator of the solvency ratios in terms of stock (debt/stocks of public assets), but of removing from the numerator the flows that contribute to the growth of physical or natural capital (debt-programmed investments contributing to the acquisition of public assets). This is also a long-standing issue that has given rise to much debate, particularly in the context of discussions on budgetary rules, especially in the European Union. The same arguments can be put forward to defend or incriminate this approach for developing countries. In particular, the economic and social profitability (in terms of global public goods) of future investments is even more difficult to assess and therefore more uncertain than that of existing capital. However, this approach seems consistent with international aid, which now has two main focuses: development and global public goods.

• Whatever the perspective, it is essential to integrate the climate dimension into medium- and long-term debt sustainability analyses (DSA), with a view to mobilising and catalysing external financing (official and private), or guiding debtor countries' debt strategies over the medium and long term. The adoption of appropriate methods for dealing with climate risk and the implementation of climate stress tests are possible ways of refining the DSAs. It is a question of finding a balance between the need to include the climate dimension in order to enable countries to strengthen their resilience, and the need to reflect the conclusive constraint that debt ultimately represents. Extending the time horizon of debt sustainability analyses also seems essential in order to take into account physical and transitional risks as well as the investments that reduce them. The inclusion of private creditors on the one hand and domestic debt on the other, whose weight is growing, is also essential. Finally, transparency is a determining factor for the credibility and support of creditors, both in terms of debt sustainability analyses and responsible debt strategies on the part of debtor countries.

• The climate dimension must also be better integrated by the rating agencies in order to mobilise private financing and limit the financing costs for vulnerable countries. While these agencies have begun to take climate vulnerability into account in their ratings, the low differentiation between project risk and country risk ratings penalises the financing of adaptation or mitigation projects, which are generally given a sovereign rating. Greater transparency and dialogue between the rating agencies, the beneficiary countries and the project promoters are therefore necessary in order to develop ratings for adaptation and energy transition projects that take into account the expected economic, social and environmental returns, and in particular the growth gains linked to the climate transition.

Financing Instruments Tailored to Climate Risks and Policies

• Global risks – macroeconomic, environmental and geopolitical – have increased. This increases the vulnerability of debt, particularly for emerging countries and especially low-income countries. In this context, the search for instruments to reduce the impacts of these risks through insurance-type instruments is one of the most natural solutions. This type of instrument seems particularly well suited to the physical risks generated by climate change. These events are completely independent of the actions taken by local authorities. However, the impact of these events is directly dependent on the adaptation policies implemented by these authorities. However, the moral hazard attached to any insurance instrument is reduced and can be further limited by ad hoc clauses. In this context, it would be useful to develop a broader range of tools, ranging from the development of *State-Contingent Debt Instruments (SCDIs)*, which are currently attracting renewed interest, to the ability of institutions such as the IMF to mobilise resources counter-cyclically or to leverage private insurance.

• The first type of instrument consists of financing with automatic debt rescheduling clauses in the event of an external event. For the reasons mentioned above (independence of the event from the actions of the creditor), this type of instrument is very well suited to natural disasters. Recent progress has been made on natural disaster clauses, which provide debtor countries with liquidity relief in the event of shocks, including pandemics in the latest version. In September 2022, Barbados issued a bond with natural disaster and pandemic clauses, providing for a suspension of payments in the event of a new global pandemic declared by the WHO. In November 2022, in preparation for COP 27, the International Capital Markets Association (ICMA) published a model of Climate Resilient Debt Clauses (CRDCs) in sovereign bonds. This initiative is strongly supported by the British Government, which has introduced such clauses in its export financing and is working with many multilateral and bilateral lenders to develop them. For the past fifteen years, Agence Française de Développement (AFD) has been offering its clients "Highly Concessional Contra-Cyclical Loans", which contain clauses of this type with a trigger linked to the terms of trade (international price of a raw material exported by the debtor). The success of this type of loan has been mixed, but the lesson we can draw from it is, as with all contingent debt instruments (particularly the best-known, such as GDP-linked bonds), that a sufficient amount of debt must be contingent on the same type of event to protect both creditors and the debtor. There is therefore a problem of coordination between creditors and comparability of treatment. Indeed, if official creditors adopt such clauses, difficulties may arise in the event of private co-financing in the absence of comparable clauses on the part of private creditors. Another issue related to the development of such clauses is the definition of the trigger event. Indeed, the diversity of natural disasters can be an obstacle to the implementation of standardised instruments and indicators.

• With this in mind, multilateral institutions have in recent years developed tools to reduce debt servicing in the event of a natural disaster. The IMF has gradually adapted its financing to respond to emergencies related to natural disasters (Ferdi Policy Brief B227, see illustration below). For example in 2015 with the Catastrophe Containment and Relief Trust (CCRT) which succeeded the Post Catastrophe Debt Relief Trust, to deal with the consequences of the Ebola epidemic. The purpose of this trust fund is to cancel debt service owed to the IMF by poor and vulnerable countries affected by a natural disaster or epidemic over several years. It is financed on a voluntary basis by donations from IMF member countries. This is also the rationale behind the initiative taken by the G20 countries to suspend debt servicing for more than 70 vulnerable countries during the Covid epidemic (between May 2020 and December 2021).

• The second type of instrument is more directly insurance-based. The aim is no longer to relieve debt servicing in the event of a natural disaster, but to compensate for all or part of the damage caused. Private insurance alone cannot do this. On the one hand, the risks are increasing sharply as a result of climate change, and on the other, this increase is very difficult to predict. Consequently, the price of insurance is very high. This does not mean that public/private partnerships cannot be devised to encourage greater coverage of this type of risk. Regulators can help. This is the purpose of the initiative of Japan's G7 Presidency in collaboration with the International Association of Insurance Supervisors (IAIS) and the Global Climate Risk Shield launched by the G7 and the most vulnerable countries in November 2022.

Key Developments in IMF Financing for Poor Countries[34]

At the top of the arrow, developments concerning the financing delivered by the PRGF, at the bottom the creation of other specific financing funds open to eligible countries.

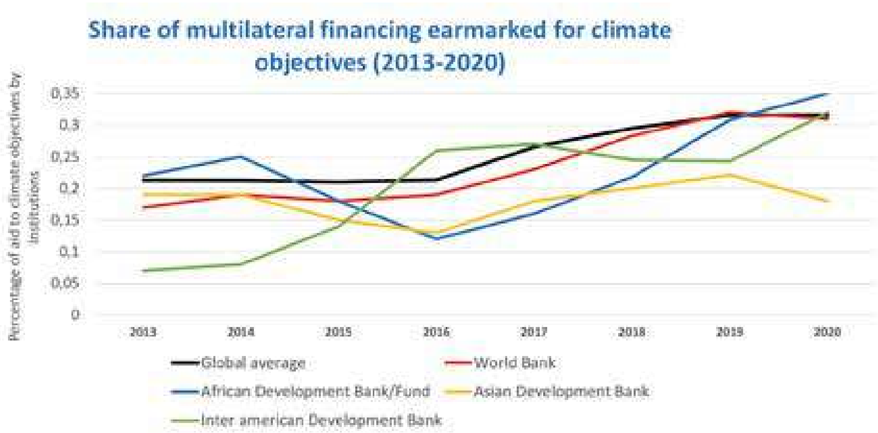
Acronyms: Extended Credit facility, Rapid Credit Facility, Standby Credit Facility. The other facilities for poor countries (in green) are issued

by the Post-Catastrophe Debt Relief Trust Fund (ADAC/Post Catastrophe Debt Relief) then the Disaster Assistance and Response Trust Fund (ARC/ Catastrophe Containment and Relief Trust), Resilience and Sustainability Trust (RST).

Source: IMF.

• Finally, the development of multilateral financing instruments to respond to shocks has increased multilateral institutions' potential to participate in financing the repercussions of natural disasters. A third of multilateral funding is thus dedicated to climate objectives (see graph below), often with the explicit objective of using leverage to mobilise private financing. This is the rationale behind, for example, the Global Climate Risk Shield facility launched by the World Bank in November 2022 in support of the G7 initiative mentioned above. The discussions launched by COP 28 on a fund to compensate for loss and damage are also a natural extension of this approach.
Source : OCDE-CAD.

34. FRPC eligible.



Source: OCDE-CAD.

• These approaches seem less well suited to the significant risks of transition. Contingent or insurance-based instruments cannot be applied to risks that are public policy-related. In such cases, the instruments used must instead aim to support mitigation policies, rather than to protect against transition risks. An initial path, already widely explored, is that of climate conditionality. This can be integrated into project aid (only green investments are financed), but it can also be an element of conditionality in budgetary aid, whether or not it is earmarked. The disadvantage of this type of conditionality is that the greening of funding for the poorest or most vulnerable countries is not explicitly accompanied by an increase in aid volumes. On the contrary, if this greening entails additional costs, it may imply a reduction in the economic and social returns on the investments or policies financed.

• But there are other ways of doing this that are more in the nature of incentive policies: additional funding, to avoid any windfall effects, linked to greenhouse gas emission reduction targets. This could be accompanied by an increase in debt ceilings (see above). The advantage of this approach is that it materialises the additional financing associated with mitigation or transition policies. However, the gains derived from these policies relate to the preservation of a "pure" global public good (the climate) and therefore follow a very different logic from that of official development assistance. The crowding-out effects of development aid flows by this type of financing could therefore be limited, particularly if they are distributed through specific channels (ad hoc cross-sectoral funds, or trust funds in MDBs). If initially it seems realistic that these channels are financed on a voluntary basis, thus systematizing the multi-stakeholder approach of Just Energy Transition Partnerships (JETPs), an international agreement on the basis of a fair sharing of the burden of mitigation is naturally desirable. These new channels are intended to raise additional resources, but they should not exacerbate aid fragmentation. That is why it would be better to create trust funds within existing institutions, including

MDBs, as is already the case at the Asian Development Bank (ABD), with the Energy Transition Mechanism.

• The third possibility for additional financing of mitigation policies is to capitalise on the preservation of natural capital that contributes to the reduction of greenhouse gas emissions. This approach has been explored since the late1980s through debt-for-nature operations (Quentin *et al.*, 2022). In recent years, there has been a revival of interest in this approach, albeit more intellectual than operational. The amounts concerned remain very limited because of the difficulties involved in implementing them, both for creditors and debtors. Some of these difficulties relate to the nature of the transaction (i.e., debt reduction). There seems to be a consensus that this type of instrument can make a contribution in specific cases, but cannot by itself restore the sustainability of a country's debt. The publication of guidelines could nevertheless be useful for developing this type of operation. This raises the question of additional financing not linked to debt, in particular the valuation of carbon credits linked to the existence and preservation of carbon sinks (the Congo Basin in Africa in particular). As noted in the Geneva report, current carbon credit systems appear fragmented, not very credible and under-remunerated, and fairer remuneration for efforts to conserve natural carbon sinks is in line with the demands made by African states at the COPs. The main difficulty that remains to be resolved is how to value the gains associated with preserving natural capital, particularly in terms of a counterfactual (what would have been done if this funding had not been available?). However, the poorer and more vulnerable the countries are, the less significant any windfall effect.

• Even if the logic of additional financing linked to mitigation policies limits the crowding-out effects of development financing, it does not necessarily resolve the trade-offs between the various SDGs, including the trade-off between adaptation and mitigation policies. We would then need to consider additional funding linked to achieving all the SDGs rather than targets linked solely to climate policies. But if this were the case, the rationality and efficiency of fund-raising on a burden-sharing basis for a global public good would become blurred.

• Finally, over and above the development of new financing instruments adapted to take account of climate risks and policies, a review of the impact of existing regulations on the availability and cost of financing for projects related to adaptation to climate change and the energy transition could also be undertaken. While prudential rules are absolutely essential to guarantee greater stability in the financial system, it would be interesting to analyse their impact on the geographical scope of institutional investments. The application of the Basel III and IV and Solvency II regulations may have had the effect of increasing the cost of cross-border and non-OECD financing. A study of the impact of this application on access to financing for countries vulnerable to climate change could be an avenue worth exploring.

Part 3
Allocate Funds Where they are Needed the Most

Proposal 7

Make that concessional development funds be allocated in priority to poor and vulnerable countries.

Taking into Account Vulnerability in the Global Distribution of Concessional Flows*

Patrick Guillaumont

In the run-up to the Paris June Summit, the question of mobilizing new resources to finance development and global public goods seems to receive much more attention than the way in which these new funds, like the old ones, are allocated among countries.

If there is to be a "financing pact", it should be with countries, for whom allocation is crucial. Some priority is to be given to countries that are vulnerable to varying degrees to exogenous shocks, external or natural.

Why Vulnerability Matters and Should Be Taken Into Account in Aid Policies

Vulnerability is the risk of a country being affected by shocks of exogenous origin. It depends on the likely size of shocks, on the exposure of the country to these shocks, and on its capacity to cope with them, the so-called resilience. Vulnerability

* Guillaumont P. (2023) "Taking into Account Vulnerability in the Global Distribution of Concessional Flows", FERDI *Policy Brief* B246. This document was produced as part of the intervention of Patrick Guillaumont (FERDI) on March 16 in the Working Group I "Enhancing the offer of international financial institutions and the international financial architecture" for the Paris June 2023 Summit.

may take various forms according to the origin of the shocks (external, natural, policy related)…

The negative impact of these shocks, either linked to the instability of the price of commodities or to the recurrence of droughts or to natural disasters or to conflict has long been established in the literature. Their negative impact has been evidenced on economic growth, but also on various aspects of sustainable development (poverty, inequality, as well as on governance, quality of policy, corruption…).

Shocks and related vulnerability are felt to be of increasing importance, in particular with respect to climate change, what motivates the international pressure to see them better taken into account, and also with respect to insecurity.

Three Reasons to Clearly Take Vulnerability into Account : Justice, Effectiveness and Transparency

First, justice: vulnerability has been seen as a structural handicap to growth, which justifies a support from the international community to make countries opportunities more equal. It is in this spirit that vulnerability has been introduced as one of the criteria for identifying LDCs.

The second reason is about aid effectiveness. It has been shown in the literature that development assistance is marginally more effective in countries facing shocks, because at the macro level it acts ex post as a stabilizer. And ex ante it may or should be seen as a kind of insurance mechanism or safety net, particularly needed in poor and risky countries, threatened to fall in poverty trap. At the microlevel it may be also the role of aid to support relevant insurance schemes in vulnerable countries.

A third reason to clearly take vulnerability into account in the design of aid policies is that it could make this design more transparent and avoid the proliferation of exceptions and specific facilities. The countries specificity and needs can be addressed otherwise in the design and management of operations.

How to Clearly Take Vulnerability Into Account

Vulnerability can be made an operational concept for the repartition of concessional funds by two ways: by the rules of eligibility to these funds and by the rules of allocation of these funds among countries. Categories are needed for eligibility, criteria for allocation.

There is no satisfactory category to address vulnerability

The Least Developed Countries (LDCs), the only official UN category, relies on three criteria among which vulnerability, the other two being income pc and human capital. But this does not prevent many non-LDCs, especially those graduated or graduating from the category, from being highly vulnerable. The category could be extended to the non-LDCs most vulnerable countries, thus covering the least developed and most vulnerable countries (LDVCs). But it would involve to significantly change LDCs identification rules.

The Multilateral Development Banks (MDBs) have indeed defined the countries eligible to their concessional windows (IDA, ADF). They have done so on the basis of a group of "low" income pc, to which they have added on an ad hoc basis a complementary list of generally small countries, which partly corresponds to situations of vulnerability.

They have also identified a group of "fragile states", with varying names and content, used as a means of taking a specific form of vulnerability into account, the weakness of the state, by opening a specific window for these countries: FVC (Fragility Violence and Conflict) at IDA, TSF (Transition States Facility) at ADF.

Even applied to other forms of vulnerability (climate) with specific facilities, creation of new groups is not enough to fairly address vulnerability in the allocation of funds.

First it raises the question of the respective thresholds of access and exit (any country is either inside or outside), even if it can indeed be answered by intermediate zones or transitory measures. Second adding various sub-categories accentuates the risk of a lack of global consistency, with inequitable effects.

Third and above all, the creation of new groups leaves unsolved the issue of allocation between countries (within the groups or sub-groups) as to some trade measures. In short, even if categories are useful for eligibility to specific windows, continuous criteria of allocation among countries, notably including vulnerability, are clearly needed.

Wrong Reasons of a Reluctance to Use Vulnerability Criteria in Allocation

However, until now, MDBs have been reluctant to introduce vulnerability into their Performance Based Allocation (PBA) formula (except the Caribbean Bank of

Development, a similar exception being that of the European Commission since 2014 for its development funds). Why this reluctance? Few bad reasons given.

One is the fear that the introduction of vulnerability criteria will be at the expense of the performance criterion. It should be underlined that the vulnerability considered is an exogeneous vunerability (beyond the present will of the country). Moreover it has been shown that the two criteria may be made perfectly compatible and that the PBA can effectively be transformed in a Performance and Vulnerability Based Allocation (PVBA).[35] [36]

Another is to say that the allocation is often only partially used, due to a low absorptive capacity of recipient countries, the responsibility for which is indeed shared between donors and recipient countries, questioning the operating mode of the MDBs and their risk aversion.

A third reason seems the risk that a display of vulnerability levels affects the notation of countries by agencies. Agencies anyway are quite aware of the vulnerabilities of countries. The fact that these vulnerabilities are taken into account an allocation formula can be seen as showing there is indeed an insurance mechanism at work likely to lower the impact of vulnerability. And most vulnerable countries wish their structural vulnerability to be reco-gnized. It can also be said that being recognized as vulnerable for exogenous reasons is less stigmatizing that being included in a group of "fragile states" (whatever the name they are given).

Finally a practical reason seems due to the fear of not being able to establish a robust and consensual indicator of vulnerability, a fear that should disappear with regard to the great deal of work done to design truly exogenous vulnerability indices.

How Can Vulnerability be Measured to Be a Relevant Criterion for Aid Allocation?

A major process of elaboration is ongoing at the UN at the request of the small islands states to promote a so called "multidimensional vulnerability index" (MVI), which is to be available around the time of the summit after consultation with member countries. (The Commonwealth Secretariat a little earlier produced a similar work, called "Universal Vulnerability Index").

35. In the formula it can be managed without lowering the share going to the most performant countries.
36. At the same time the vulnerability linked to present policy (the weakness of resilience policy) should be included as a negative factor of performance.

Alongside the usual requirements of a composite index (availability of reliable data and relative simplicity) this composite indicator must and will have 3 specific features.

(i) It has to be exogenous or structural, reflecting factors beyond the present control of countries, to be used effectively as a financing criterion (without moral hazard);

(ii) It should be "universal", what means relevant for various kinds of vulnerable countries, and not only the Small Island Developing States (SIDS);

(iii) Then it must be multidimensional, i.e. it should include an economic dimension, which has been identified and analysed for a long time, but also an environmental dimension, and more particularly the vulnerability to climate change, and finally a social dimension or exogenous socio-political fragility (such as revealed by the presence of violence and insecurity at the borders, or the recurrence of epidemics).

There is no need of a specific health dimension of vulnerability, because health-related vulnerability is captured by various ways through the three dimensions noted above.37

The index being finalized at the UN will probably meet these principles and could serve as a reference at the Paris Summit.

To be noted, the vulnerability to climate change has been the main driver for the consideration of vulnerability (The Summit was announced at the end of COP27), but it has rapidly been agreed in building a relevant index that it cannot be limited to that dimension.

The Allocation Criteria (and Indicators) Should Be Adapted to the Objectives of the Various Financial Instruments

This seems obvious for climate finance.

If it is a question of mitigation, the allocation criteria must first aim at effectiveness. But credits for mitigation must also provide concessional financing for the

37. Adding a fourth (health) dimension would be both difficult and redundant First, it is difficult to assess the probability of health shocks, as done for the economic and climatic shocks, although the third or social dimension may include a component such as the number of deaths due to the recurrence of epidemics. Second, the economic consequences of health shocks are captured through indicators of economic vulnerability. Third health indicators are to be included as components of the "structural resilience". Indeed the notion of "health vulnerability" is ambiguous: it refers not only to possible consequences of health shocks, as just explained, but also to the health consequences of any kind of shocks (external, or climatic, or socio-political).

additional costs of using low-carbon technologies in LICs, according to income pc and possibly vulnerability criteria.

For the allocation of adaptation credits, the vulnerability criterion is particularly important: it must rely on a physical vulnerability to climate change index, totally exogenous and capturing the main physical manifestations of climate change in the country, as done by the FERDI PVCCI.

For the compensation of losses and damages, the evaluation of these is almost impossible, as it is difficult to distinguish what is the result of climate change (for which the countries of the North are responsible) and what is due to the climate in its historical component, and also as it is difficult to distinguish in the losses and damages what is really exogenous and what is due to the management of risks by the countries and their preparation: a preventive approach is as important as curative action, which could still lead to allocate (in part) according to the physical vulnerability to climate change.

Recommendations

The final allocation between countries of the new resources mobilized, as well as of the old ones, should be at the heart of a Summit intended to reshape international financing and address vulnerabilities of developing countries. This involves an international consensus on the rules of eligibility to the concessional resources, and above all on continuous criteria for their allocation among countries.

In addition to per capita income, which should not be the only differentiation criterion, vulnerability criteria likely to reflect a structural vulnerability, independent of current policy are to be taken into account. Vulnerability linked to a bad current policy should, on the contrary, diminish the measure of performance/governance and affect allocation in the opposite direction.

The structural vulnerability criterion must capture the various forms of vulnerability that countries face, still independently of their present will, through specific indicators related to economic vulnerability, vulnerability to climate change, social vulnerability, which includes the fragility linked to exogenous insecurity.

To be fully consistent, these allocation principles should apply to all existing and new concessional financing. This involves significant changes in the allocation formulas of MDBs concessional windows, where vulnerability has not yet been clearly and transparently integrated. This could condition their legitimacy to manage all or part of the new funds that will have been mobilized. The prospect of a consensus on a new multidimensional vulnerability index (MVI) or at least on the principles of its construction should contribute to promote this consistency.

In order to inform the international community about current practices and to monitor the implementation of the principles set out, an index of the quality of allocation with regard to the multidimensional vulnerability criterion would be established annually. It could be for each donor (multilateral and bilateral) the weighted average level of the vulnerability indices for each recipient country. This calculation would be part of a new measure of the "selectivity" of concessional flows.

Of course, allocation is not all what matters. Besides allocation among countries (in part) according to vulnerability, MDBs should be invited to focus their operations into directions leading to risk reduction in vulnerable countries, and also to report on this matter.

If there should be a global financing pact between countries, the commitments on the amounts mobilized and the instruments implemented would have to be accompanied by commitments on the rules for their distribution between countries.

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Why Creating a General Category of Vulnerable Countries is Not Suitable*

Patrick Guillaumont

As part of the preparation for the June Summit on financing, the question was raised as to whether a category of "vulnerable countries" should not be created or recommended. One would first have to ask who would be responsible for creating this category, so that it would be authoritative. Only the United Nations has the legitimacy to do so and a negative answer was given there when the question was asked five years ago. It could indeed be imagined that this position might change. But to understand what is at stake and examine the question in depth, it is necessary to recall this historical point.

A Recent Rejection

In 2018 the United Nations Committee for Development Policy (CDP) linked to ECOSOC and in charge of monitoring the evolution of the category of "Least Developed Countries" (LDCs), by designing the identification criteria and proposing the inclusions into the list and the exits from it, had suggested creating a category of countries "facing extreme vulnerability to climate change and other environmental shocks". It did so apparently to respond to the recurring criticisms made of it on the graduation rules applied to the countries that have already graduated or are in the process of graduating: These were generally small countries no longer being low-income, nor being characterized by a particularly low level of human capital, but still vulnerable with regard to the vulnerability index that the Committee had itself built and is the third criterion for identifying LDCs.

The need for a new category then seemed to be justified only by the difficulty, no doubt overestimated, of modifying the graduation criteria for the LDC category.

* Guillaumont P. (2023) "Why Creating a General Category of Vulnerable Countries is Not Suitable", FERDI *Policy Brief* B247.

In fact, such a modification could have been done by aggregating the criteria for identifying LDCs into a synthetic criterion, which would have involved always taking vulnerability into account. ECOSOC having clearly ruled out the possibility of creating a new category of vulnerable countries (E/RES/2018/27), the concern of the countries concerned, the small island States in particular, was expressed through a Resolution of the UN General Assembly calling for the establishment of a "multidimensional vulnerability indicator" that could be used to guide financial flows to vulnerable countries.

Several Specific Categories for the Eligibility to Concessional Funds

Without a general category endorsed by the UN, development financial institutions having a concessional window have set up conditions of eligibility to this window, what de facto results in specific categories. The main condition generally applied is a maximum level of income per capita, while additional countries may also be made eligible on a discretionary basis. A vulnerability criterion is generally not used as a condition of eligibility, but it could be, combined with the income per capita.

What is today at stake is the creation of a new and general category of vulnerable countries, likely to be used by all the main financial institutions.

Reasons for Avoiding to Create a New and General Category of Vulnerable Countries

There are in fact severals reasons why the creation of a new category of vulnerable countries is not desirable.

The first, unfortunately illustrated by the experience of the LDC category, the only official category recognized by the United Nations, is that the use of a category always raises problems at its borders, in particular when belonging to the category generates specific advantages and exit from it from it is on the agenda. The LDC category is precisely discussed because of this "graduation" issue. Hence the laborious search for "smooth transition" measures. The financial institutions that have set up eligibility conditions for their concessional windows had to use transitory measures for countries no longer meeting these conditions.

The second and most important reason, also illustrated by the case of LDCs, is that the use of a category tends to make the member countries considered as a block and leads to not differentiating among them. It is better to differentiate vulnerable countries on the basis of vulnerability criteria than to consider them as a homogeneous whole. This has now become clearer than ever before, thanks to the emerging consensus on a multidimensional indicator of vulnerability.

A third reason for not proposing the creation of a new category relates to a possible confusion with the category of least developed countries with which a category of vulnerable countries would inevitably and largely overlap. This overlapping could further contribute to the fragmentation of funding, as far as the creation of a new category would create pressure for a new financial instrument to meet the specific needs of vulnerable countries, needs difficult to distinguish from the needs of LDCs, if not through continuous criteria.

Let us add that, since vulnerability is multidimensional, the wish of a new category might become a wish of several categories corresponding respectively to each dimension, each with the same problems than those identified for a general category, and with an additional risk of category overlapping. Nevertheless, the dimension with regard to which it would be assess an exogenous vulnerability is vulnerability to climate change.

For these three reasons, the use of continuous vulnerability criteria that can guide the distribution of concessional financing between countries is highly preferable to the creation of a new category.38

If, However…

If, however, for political reasons it was really necessary to have a category gathering the most vulnerable countries, a possible solution would be, rather than create a new category, to revise the category of LDCs, so that it becomes a category of "least advanced and most vulnerable countries". This would imply an in-depth, but ultimately quite simple, revision of the criteria for identifying member countries. It would indeed suffice, as indicated above, to aggregate the three identification criteria of the LDCs category into a synthetic criterion where vulnerability would have, alongside per capita income and the level of human capital (the other two criteria) a suitable place. The Committee for Development Policy could commit to this only if it received a specific mandate in this sense from ECOSOC, to which its proposals are intended.

38. See on this subject Guillaumont P. (2023) "Financing global policies: but for whom?" FERDI *Working Paper* P319 (Work of the International Development Finance Architecture Chair), and "How vulnerability should impact the global distribution of concessional flows", FERDI *Policy Brief*, B246, March 2023.

Even if a reform of the LDCs identification criteria in the direction indicated is desirable, it is not sure that it can or even should go as far as a change in the nature of the category, which has gradually imposed itself and around which a series of dedicated international bodies have been established.

Nevertheless, as soon as there is a consensus on a multidimensional vulnerability indicator and criterion, any supplier of concessional finance can use it, according to its own principles, and alongside with other possible criteria such as the income per capita, to set up an indicator threshold determining the eligibility to special financial windows. It can thus design its own category of target countries, while the consistency in the allocation of global financing will not be insured.

In short, to better allocate concessional finance among countries, the effective use by donors, in particular the multilateral ones, of vulnerability criteria continuous, preferably homogenous, and not exclusive of other ones, is more important than the creation of a new category of vulnerable countries or even the transformation of the category of LDCs into a category of "least developed and most vulnerable countries".

Assessing "Aid Selectivity" by Considering the Vulnerability of Countries*

Patrick Guillaumont, Sylviane Guillaumont Jeanneney

The Paris Summit for a New Global Financing Pact in June 2023 was initially announced as a response to country vulnerabilities, in particular vulnerability to climate change. Support for vulnerable countries remains one of the principles of the Paris Pact for People and Planet (4P) that emerged from this summit.[39] Whatever the sectoral allocations or financial instruments recommended, it is necessary to ensure that the funds mobilised, especially those added to existing funding, will actually benefit vulnerable and poor countries or respond to situations of vulnerability.

In the early 2000s, when the fashionable idea was to ensure that the allocation of aid favoured the best-governed countries, the concept of "aid selectivity" emerged, with the aim of assessing the extent to which, for each source of aid, flows were well directed towards these countries. This definition of selectivity stemmed from the thesis of Burnside and Dollar (1997, 2000a and b, 2004a and b) that aid would be effective in promoting growth (and thus reducing poverty) only in well-governed countries. It was used by many authors in the 2000s (World Bank, 1998, 2004[40]; Dollar and Levin, 2004; Roodman, 2004; World Bank and IMF, 2004). It can also be found in well-known works on the relationship between aid and poverty reduction (Collier and Dollar, 2001 and 2002). Since 2003, the Center for Global Development (CGDEV) has published the Commitment to Development Index (Robinson, Beata Cichocka, Ritchie and Mitchell, 2021), which

* Guillaumont P., Guillaumont Jeanneney S. (2024) "Évaluer la "sélectivité" de l'aide, en considérant la vulnérabilité des pays", FERDI *Policy Brief* B261.

39. The four principles are as follows
 - no country should have to choose between fighting poverty and preserving the planet ;
 - each country adopts its own transition strategy, taking into account its needs and constraints to achieve the goals of the Paris Agreement;
 - a shock of public funding is needed to help vulnerable economies lift their populations out of poverty, while protecting the planet;
 - a much greater leverage effect is needed to increase private funding for our global challenges.

40. The Global Monitoring Report divided aid-receiving countries into two categories of equal size on the basis of CPIA alone, those with 'good policies and institutions' and those with 'bad' ones.

aims to rank developed countries according to the contribution of their economic policies to the development of poor countries (aid, trade, migration, investment, security, technology and environmental policy). Until 2021, the aid component included the governance of assisted countries as a criterion for aid selectivity (Birdsall, Mahgoub and Perakis, 2010).

This concept of selectivity, tainted by its connotation of "good governance", has since been criticised and is no longer widely used.[41] On the one hand, the definition of "good governance" that would be identical everywhere has been called into question. Above all, it is now recognised that economic growth is only one of the goals of aid, even if poverty reduction is linked to it, and that the effectiveness of aid does not depend solely, or perhaps primarily, on the quality of economic policy. It also (and mainly) depends on the handicaps suffered by the poorest countries that need to be overcome. Structural handicaps are also used by the United Nations to define the category of least developed countries (LDCs). These are the weakness of human capital and the vulnerability of countries. The importance of vulnerability in aid effectiveness is now well recognised (Collier and Dehn, 2001; Guillaumont and Chauvet, 2001[42]; Collier and Hoeffler, 2004 in post-conflict situations).

In an article published in *World Economy* in 2007 (Amprou, Guillaumont and Guillaumont Jeanneney), we proposed a new measure of selectivity that, without abandoning the governance criterion but showing its limitations, simultaneously used other criteria to judge the quality of aid flows' geographical orientation. These criteria included not only a low level of per capita income and human capital but also the level of economic vulnerability, measured at the time using the indicator calculated by the United Nations Committee for Development Policy (CDP) to identify LDCs. In the early 2010s, work published by Ferdi as an extension of the above-mentioned article made it possible to update the results initially presented in the *World Economy* article (Guillaumont Jeanneney and Le Velly, 2010, 2011). It then became appropriate for selectivity with respect to a vulnerability criterion to be considered as a means of assessing the quality of public funding policies and for any progress made following the Summit to be reported in this respect.

41. For example, according to the Commitment Development Index published in 2021, which is still designed to compare the efforts of high-income countries to help poorer countries, the quality of financing for development component of this index is measured by six indicators: the degree of linkage of flows, the transparency of aid policy, the proportion of aid going through a multilateral channel, the proportion of projects corresponding to the objectives of recipient countries, the proportion of low-income countries in bilateral aid, and the proportion of countries classified by the World Bank as fragile. The governance of the countries receiving aid is no longer included in the quality of aid (Robinson et al. 2021).
42. This article deals with the shocks to which many developing countries are exposed, either as a result of the variability of commodity prices, or of climatic incidents and natural disasters. In these situations, aid is more effective by preventing the disruption of imports and the cumulative fall in growth, as it reduces the negative impact of vulnerability.

This new concept of selectivity would benefit from the in-depth analysis of the vulnerability of developing countries, particularly in recent years. A country's vulnerability is the risk of its development being hampered by exogenous shocks, whether external or natural. An essential distinction in the use of a vulnerability index in the calculation of a selectivity indicator is indeed between what is exogenous, that is, independent of the present will of countries, and what depends on their will or their present policy. Financing countries according to their vulnerability is only justified if this vulnerability is truly structural and not linked to the countries' current policies.[43] The vulnerability indicator also needs to be multidimensional. Three dimensions of vulnerability are now commonly distinguished, albeit with varying perimeters. For example, if we look at the way in which shocks manifest themselves, we can distinguish (i) economic vulnerability,[44] which is likely to capture the economic impact of various kinds of exogenous shocks (economic, environmental, health-related, etc.); (ii) vulnerability to climate change: because of the major and growing importance of this type of vulnerability, particularly for SIDS, it may be logical and convenient to consider it separately, using purely physical indicators,[45] with the impact of other forms of environmental vulnerability then being captured through the economic dimension; and (iii) social or socio-political vulnerability, which involves targeting recurring social shocks that reflect the fragility of States, this vulnerability being captured specifically by recurrent violent events, which occur either within the country or at its borders.[46]

The method that we propose for measuring the relative "selectivity" of donors is simple. For each source of aid and for each criterion used, including of course the vulnerability criteria, we calculate a weighted average indicator for recipient countries that is comparable from one source of aid to another. As it is not possible to consider vulnerability independently of the level of per capita income, the calculation must combine the vulnerability indicator with an indicator of low income (in fact its log) or, if we want to take into account a multidimensional measure of poverty in recipient countries, including the weakness of their human

43. Refusing to isolate what is truly exogenous in vulnerability would run the risk of generating moral hazard, corresponding to the incentive countries would have not to improve their policies to deal with vulnerability. This distinction between structural vulnerability and general vulnerability has been systematically made in Ferdi's work, notably in the construction of an index for the African Development Bank, then in its contribution to the elaboration of a 'universal vulnerability index' for the Commonwealth Secretariat and finally in its contribution to the elaboration of a 'multidimensional vulnerability index' for the United Nations.
44. Economic vulnerability has been used since 2000 by the United Nations Committee for Development Policy as a criterion for identifying LDCs, and the EVI index developed for this purpose has been revised several times. Its latest name is Economic and Environmental Vulnerability.
45. FERDI has developed an indicator of physical vulnerability to climate change, which takes into account two risks caused by climate change: those linked to trend shocks such as rising sea levels, increasing temperatures and decreasing rainfall, and those linked to the intensification of recurrent thermal, rainfall and cyclonic shocks.
46. See above: "Taking into Account Vulnerability in the Global Distribution of Concessional Flows", Patrick Guillaumont.

capital, it will be possible to use the weakness of the Human Development Index, which combines indicators of per capita income, education and health.

For the calculation, it is of course necessary to know the geographical distribution of the flows from each source of aid, which the OECD should normally have, and the relative shares of each recipient should be used as a weighting coefficient for calculating the average level of income (or HDI) and the average level of vulnerability of the recipients of aid from a given bilateral or multilateral source.

The measure of vulnerability used as a criterion should benefit from the progress made in this area over the last fifteen years, as mentioned above. For example, the United Nations Committee for Development Policy (CDP) has redefined its vulnerability index, and the Commonwealth Secretariat and then the United Nations have developed new multidimensional measures of vulnerability. These new indices meet the criteria required for calculating selectivity, namely a measure of structural or exogenous vulnerability, independent of the current will of the countries, to avoid any moral hazard: it is the structural or exogenous vulnerability of the recipient country that corresponds to a need for aid, whereas vulnerability linked to a poor current policy reveals poor governance, which may remain a negative criterion for allocation.

It is of course possible to add a governance or performance criterion to the two previous criteria, which was the basis of the initial measure of selectivity. However, as its assessment remains contested and is not in line with the objective of alignment with countries' political choices, which was one of the principles of the Paris Declaration on Aid Effectiveness, it is conceivable to measure selectivity according to two versions, one including this third criterion and the other not.

Whether we stick to the two criteria of a low level of development and high vulnerability or add a third criterion of governance/performance, it is easy to combine them using the most appropriate type of average and the most appropriate weighting. It is even conceivable to let each user (for their own use, if not for international comparisons) choose the type of average that they prefer, as well as the weighting between the different criteria or even between the components of each multidimensional indicator. The programme was developed at Ferdi and is called "Build Your Own Index". However, if, in the wake of the June Summit, since it was initially conceived as a summit for vulnerable countries, we wanted to ensure the accountability of development partners from this initial perspective, it would be relevant simply to assess the orientation of concessional flows in terms of a multidimensional vulnerability indicator. Each type or source of funding would thus be assigned an average indicator of the vulnerability of recipient countries. Similarly, since vulnerability cannot be the only criterion for allocating aid, the average level of per capita income or human development of recipient countries, or their average level of "performance", should be measured and compared. In the same way, it would be possible to monitor the average level of vulnerability of recipient countries in its various dimensions, or any other variable chosen as a criterion, both at the global level and for each source of aid.

Let us add that, since the variables used as criteria are partially correlated, we may also wish to measure not the average impact but the marginal impact of each of them (in this case vulnerability) by estimating econometrically the elasticity of each type of flow in relation to the different variables (including vulnerability) used as allocation and selectivity criteria. By calculating the average vulnerability of recipient countries, we can see the extent to which each source of funding has in fact focused more or less on vulnerable countries according to their level of vulnerability, while the marginal impact of vulnerability (or elasticity) attempts to show the extent to which each source, in its allocation choices according to different criteria, has been specifically sensitive to the degree of vulnerability of recipient countries. This second measure, which depends on the estimation method, can only be complementary to the previous one, the meaning of which is clearer and on which political communication is simpler (see the comparison of the two methods in Amprou et al., 2017; work in progress by Ferdi will present the respective scope of the two methods).

The recommended method is easily applicable to ODA flows. Depending on the availability of statistics, it should also be possible to apply it separately to other categories of flows to the countries for which they are intended: TOSSD and its components, FDI, as well as, in a complementary manner and subject to specific adjustments, flows intended to promote various types of global public goods.

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The Challenges of Reallocating SDRs to Vulnerable Countries*

Bruno Cabrillac, Sylviane Guillaumont Jeanneney

On 2 August 2021, the International Monetary Fund (IMF) approved a new allocation of Special Drawing Rights (SDR 433 billion or $650 billion) to meet the external reserve needs arising from the COVID-19 crisis, with effect from 23 August 2021.[47] As the Managing Director of the IMF pointed out on the day of the allocation, this need is particularly acute in developing countries, yet most of these new SDRs were allocated to industrialised countries in proportion to the quotas, most of which are held by them.[48]

While developing countries as a whole receive $274 billion (or 42% of the new allocations), low-income countries (LICs) receive only 3.2% of the new allocations, or $21 billion[49]. The IMF considers that this latter amount is much less than the foreign exchange reserve deficit of low-income countries. This is the reason a consensus, expressed at the G7 meeting in June 2021, has emerged within the international community that the industrialised countries should voluntarily 'recycle'" a portion of these SDRs in favour of low- and middle-income countries. In convoluted language, the G7 communiqué sets out an ambition of 100 billion SDRs. This commitment was taken up by the G20, which announced that it had been reached at the New Delhi Summit in October 2023. However, a lively debate has arisen over the modalities of this 'reallocation', a debate that overshadows the one on the use of this reallocation and that is still not closed since the G20 committed at the same New Delhi Summit to exploring all 'viable options'.

* Summary of the Working Paper: Cabrillac B., Guillaumont Jeanneney S. (2022) "Les défis de la réallocation des DTS en faveur des pays vulnérables", FERDI *Working Paper* P298. And in the Policy Brief by the same authors: B223, October 2021.

47. Cf. IMF (2021) *Special Drawing Rights (SDR)*, August 5. This is the largest allocation of SDRs since their creation in 1969, bringing the total amount allocated to USD 943 billion, of which it represents 70%.
48. Countries' quotas are set mainly on the basis of their GDP in purchasing power parity and marginally on the basis of their openness to the outside world, the level of reserves and the variability of capital movements. This last variable is the only one to take account of needs rather than productive capacity.
49. Cf. IMF (2021) *Proposals for a General Allocation of Special Drawing Rights*, p. 16.

It seems to us that these conditions should be defined on the basis of three considerations:

First, the nature of SDRs, which are foreign exchange reserve instruments in the form of liquidity advances that have the counterpart of a debt to the IMF, determines the purpose of their creation.

Second, the international community is committed to targeting this recycling at the most vulnerable countries.

Finally, conditionality should be compatible with the international community's commitments regarding the conditions for granting development aid, as summarised in the 2005 Paris Declaration on Aid Effectiveness that provides for 'aligning aid with partner countries' priorities, systems and procedures'.

SDRs, Special Foreign Exchange Reserve Instruments

The SDR is defined as a basket of currencies that has included since October 2016 the Chinese yuan alongside the dollar, euro, yen and pound sterling, with different weights associated with these currencies. SDRs are primarily held by IMF members (generally by their central banks) that participate in the SDR Department (in fact, all IMF member states) and secondarily by the central banks of the currency unions and by official entities, currently numbering twelve, including the Bank for International Settlements (BIS) and the multilateral development banks. The SDR is therefore an asset that circulates only between official holders. The SDR is neither a currency nor a claim on the IMF, but it is both an asset and a liability, both bearing the same rate as the asset can be separated from the liability. It constitutes a right to obtain 'freely usable'' currencies, that is, fully convertible, and it is for this reason that it is included in the official foreign exchange reserves. Exchange of currencies for SDRs is carried out by states with significant external reserves, either voluntarily, through voluntary exchange agreements signed between the IMF and an official holder or by designation by the IMF. Since 1987, the IMF has not had to intervene.

Allocated SDRs are recorded in accounts held by the IMF. Holding these SDRs does not entail any cost[50] since the assets and liabilities bear the same interest rate, unlike when they are used, which separates the assets from the liabilities. When the amount of SDRs held is less than the original allocation because of their use, the state must pay the IMF interest on the difference. Conversely, if the amount of

50. The SDR Department pays interest on each member's SDR holdings and simultaneously charges equivalent interest on the allocation. Interest received and charges paid offset each other.

SDRs is greater, the state receives interest. The interest rate is a weighted average of the interest rates on the three-month public debt of the countries that have their currencies included in the SDR basket, with a floor of 5 basis points. It is calculated daily by the IMF; thus, it is a regulated rate rather than a pure market rate.

The recycling of SDRs must depend on their purpose. SDRs were created in 1969 by the IMF in the context of an international system of fixed exchange rates. From the outset, the objective was to ensure the stability of the world economy by meeting long-term external reserve requirements, which are particularly important in a fixed exchange rate regime. While the major countries have all adopted a free-floating currency regime, this is not the case for low-income countries, which have either a fixed exchange rate or a controlled float. The first use of SDRs directly allocated or recycled may correspond to their original purpose, which is to build up additional foreign exchange reserves to avoid a currency crisis. Many developing countries, particularly in sub-Saharan Africa, do not have enough reserves. Kenya and Ghana, for example, have chosen to top off their foreign exchange reserves with most of the SDRs that were directly allocated to them. For the countries most concerned about maintaining access to capital markets, an increase in the level of reserves is also required. However, keeping SDRs in reserves does not prevent them from being used to finance the budget in derogation of the rules that almost everywhere, even in developing countries, prohibit or limit direct monetary financing of states.

The lack of external resources in low-income countries is structural, and balance of payments crises are a recurring feature. The international community, mainly through the IMF, has tried to alleviate these problems. Thanks, in particular, to the existence of a Rapid Credit Facility and the temporary raising of access ceilings, the IMF rapidly responded to the COVID crisis, which affected more than two-thirds of the countries eligible for the Poverty Reduction and Growth Facility (PRGF), increasing its new commitments sixfold in 2020. From 2021 to 2023, when the bulk of the IMF's new commitments were again in the form of PRGFs, the amount was more than double the average for the decade preceding the COVID crisis. In addition, debt servicing to bilateral public creditors was suspended from May 2020 until the end of 2021. Finally, the multilateral development banks have increased their financing. These contributions have only partially met the financing needs of low-income countries in the face of the shock of the pandemic crisis, as shown by the weakness of their economic support policies. In addition, the international context is once again putting pressure on low-income countries. In this context, the purpose of reallocating SDRs to these countries is to relieve the external constraint on their economic support policies and increase their 'fiscal space'. To achieve this objective, two questions need to be answered:

1) Which country should receive the recycled SDRs?
2) Should the granting of SDRs be subject to conditions?

The Vulnerability of Recipient Countries, a Logical Criterion for Allocating SDRs

Given the foreign exchange reserve nature of SDRs, the aim would be to allocate them to the countries most vulnerable to a balance of payments crisis. Since the IMF's rules provide for allocation on the basis of quotas, which take more account of countries' ability to contribute than their needs, the recycling of part of this allocation should seek to re-establish the logic of countries' relative vulnerability as a criterion for redistribution. It is true that an excessively expansive, even adventurous, policy on the part of governments can lead to an excessive widening of the external deficit, and it is not up to the international community to encourage them in this direction. But governments are also faced with balance of payments crises due to exogenous shocks, such as the COVID pandemic or, more recently, the war in Ukraine, which have widened the external deficit of low-income countries through multiple channels.

Under IMF rules, the purpose of SDRs is to meet long-term balance of payments requirements. Article XVIII of the IMF Articles of Agreement (March 2020 version) states that 'in all its decisions on allocations and cancellations of Special Drawing Rights, the Fund shall seek to meet the overall long-term need...'. If low-income countries find it difficult to mitigate the consequences of external shocks, it is because of their long-term structural handicaps. Rawls's or Sen's definition of equity as equality of opportunity justifies compensating for these structural handicaps with aid,[51] especially in the face of global dysfunction.

For several decades, the notion of structural economic vulnerability has been the subject of considerable reflection in the academic world and by international institutions. Several indicators of structural vulnerability of a multidimensional nature (economic, environmental and sociopolitical) have been constructed with a view to guiding the geographical allocation of concessional international financing to low-income countries.[52] If an international consensus emerges on an appropriate structural vulnerability index, it could be used to determine the geographical distribution of recycled SDRs. Moreover, the willingness to use such an index for this purpose could prove to be a stimulus to the search for an international consensus on the composition of this indicator.

The desire for redistribution according to the relative vulnerability of countries poses a problem if it is carried out through multiple channels (see below in the section 'The different options for reallocating SDRs'). Even if each institution or

51. Cf. Guillaumont P., Guillaumont Jeanneney S., Wagner L. (2020) *Measuring vulnerabilities to improve aid allocation, especially in Africa*, FERDI, 80 p.
52. See above: "Taking into Account Vulnerability in the Global Distribution of Concessional Flows", Patrick Guillaumont

government responsible for allocating SDRs took into account the degree of vulnerability of the recipient countries, it would be desirable for a global accounting system to be established for the geographical distribution of reallocations according to a commonly accepted structural vulnerability indicator (potentially by the IMF) and for a specific fund to have the role of dealing with the case of 'orphan countries', according to the customary expression for development aid.

The Question of the Conditionality Attached to the Reallocation of SDRs

Over the past 20 years, the question of the conditions placed by donors on the disbursement of their budgetary aid has been the subject of intense debate.[53] Although it was strongly criticised by recipient countries, it was decided in 2005 that 'donors should be guided in their choice of the most effective aid modalities by the development strategies and priorities defined by partner countries'.[54] However, there has been a long way to go from words to deeds, even if progress has been made in easing conditionalities. For example, the IMF has introduced rapid-disbursing loans without conditionality (rapid credit facilities, which were widely used during the COVID crisis) and contingent credit lines with ex ante conditionality (eligibility), even for poor countries, but these have been less successful.

Will the voluntary reallocation of part of the SDRs allocated to rich countries to the most vulnerable countries represent a new advance in the autonomy of developing country governments? The nature of SDRs might suggest so. The SDR is an unconditional reserve asset that each member uses as it sees fit depending on its balance of payments situation and the evolution of its reserves.[55] Nevertheless, the IMF provides a Note of Guidance on the macroeconomic policy that should accompany the use of SDRs.[56]

In the specific case of recycled SDRs, and despite the previously mentioned nature of SDRs, two factors push for the maintenance of a certain conditionality: (i) these borrowing resources have an impact on debt sustainability and, therefore, must generate growth to enable them to be repaid; and (ii) we may wish to limit the moral hazard caused by a possible trade-off with conditional resources, in particular those provided by the IMF as part of programmes. Maintaining conditionality is also a necessary accompaniment to an allocation linked to vulnerability, sometimes in derogation of debt sustainability rules.

53. See below: "What Should Be Done about Conditionality?", Matthieu Boussichas, Patrick Guillaumont, Sylviane Guillaumont Jeanneney
54. Cf. *Déclaration de Paris sur l'efficacité de l'aide.*
55. Article XIX section 3 of the IMF Articles of Agreement.
56. Cf. IMF (2021) *Questions and Answers on Special Drawing Rights*, August 23.

Another important issue is the status of the claims represented by the recycled SDRs. In particular, will the claim on the final beneficiary constituted by the recycled SDRs benefit from a privilege or even from the IMF privilege recognised *de facto* by the international community?[57] Several factors militate in favour of this being the case insofar as (i) the IMF claim, which is the counterpart of the SDR, benefits from this privilege; (ii) many potential lending countries consider that this is a *sine qua non* condition for these loans to retain the nature of reserve assets; and (iii) it is an important element in avoiding arbitrage with IMF facilities that themselves benefit from this status (cf. above). However, it must be considered that the status of preferential claims would deprive recycled SDRs of some of their interest for recipient countries insofar as their access to private financing could be limited through a crowding-out effect.

The Different Options for Reallocating SDRs

It is against the backdrop of the two principles that flow from the nature of SDRs—helping vulnerable countries and preserving their decision-making autonomy—that we need to analyse the various solutions that have been put in place or are being considered for reallocating SDRs. Three options are on the table: the International Monetary Fund, multilateral development banks and one or more ad hoc multilateral funds. As reserve assets, SDRs must bear limited credit and liquidity risk. This is why the IMF or multilateral bank channel is preferred to an ad hoc fund independent of these institutions or to bilateral loans. However, the latter option (which does not appear to be under consideration at present) could be explored by certain developed countries because of its simplicity and with the aim of including the reallocation of SDRs as part of their specific national development aid policy.

The IMF channel, through a top off to the Poverty Reduction and Growth Facility (PRGF) or another facility (such as the Resilience and Sustainability Trust) created for this purpose, has an advantage over a loan of SDRs to a development bank. In terms of interest, the operation is neutral for both the lending country and the IMF. The lending country receives interest from the IMF but also pays interest to the IMF as it reduces its holdings of SDRs below its allocation, In contrast, if the SDRs are lent to a development bank, the latter will have to pay interest to the lending country, for which the operation remains neutral; the development bank will therefore have to compare the cost of borrowing SDRs with its other sources of financing. The sharp rise in the SDR interest rate since the beginning of 2022,

57. This privilege, de facto rather than de jure, recognises the precedence of IMF claims over all other claims. In particular, IMF claims are not included in the debt treatment procedures of the Paris Club or the Common Framework, created by the G20 in 2020. SDRs recycled through the PRGF benefit from the status of preferred creditor of the IMF for the facilities provided by this fund.

which has taken it to over 4% since the end of 2023, changes the parameters of this trade-off.

It is also possible that some low-income countries may wish to receive SDRs solely in order to boost their foreign exchange reserves. It is important for a country to have a minimum level of reserves (for example, in proportion to its imports) to ensure its credibility on the international goods and capital markets and to protect itself against a sudden balance of payments crisis leading to an uncontrollable depreciation of its exchange rate. SDRs could be borrowed either bilaterally or through a multilateral fund, potentially managed by the IMF and financed by voluntary contributions from developed countries. In terms of interest flows, the operation would be neutral for both the lending and borrowing countries as long as the latter kept the SDRs in their reserves. However, for the lending countries, the counterparty and liquidity risk would be too high in the context of a bilateral loan to guarantee the status of this SDR claim as a foreign exchange reserve. This disadvantage could be overcome through intermediation by a multilateral fund with ad hoc financial engineering similar to that of the PRGF or the Resilience and Sustainability Fund.

The other disadvantage of financing by recycling SDRs is the cost to recipient countries since this recycling takes the form of loans. Advanced countries will be reluctant to donate SDRs in the form of budgetary allocations since this would involve them paying the IMF interest for an unlimited period of time, which is sometimes higher than that at which they themselves can borrow and implying an exchange and interest rate risk, including on the capital, in the event of cancellation of the general allocation. In fact, when SDRs are held by central banks[58] and banks dispose of the assets, the state must compensate with budget appropriations to reconstitute the assets, and failing this could constitute direct monetary financing.[59]

Given the specific constraints on low-income countries, it is logical that priority should be given to reallocating SDRs to them, which is ensured by replenishing the PRGF. This solution comes up against two limits: the availability of countries to finance by means of budget grants the necessary subsidisation of loans made through these channel; and the absorption capacity of low-income countries. It also has the disadvantage of potentially replacing donors' efforts to replenish the International Development Association (IDA) or the African Development Fund (ADF). As for the absorption capacity of low-income countries, it is reduced by the

58. When SDRs are held directly by governments, there are also usually internal rules requiring the transfer to be recorded in the budget.

59. In developing countries, this constraint does not always exist and in fact results in a debt to the Central Bank, i.e. monetary financing of the State. See Cabrillac B. (2021) "Les questions posées par la réallocation des DTS", FERDI *Policy Brief* B221.

debt overhang of a large proportion of them. Another limitation could result from the cost of borrowing in SDRs, which would then be mobilised in foreign currencies or, in the case of intermediation, which would not allow loans in foreign currencies at a zero interest rate like those of the PRGF. The interest rate, which in 2022 was only 0.05% (indexed to the short-term borrowing rates of the five countries whose currencies make up the SDR basket), rose rapidly to over 4% by the end of 2023. We can envisage that recycling will also concern middle-income countries, and this is one of the challenges of the Resilience and Sustainability Fund created in 2023. Extending recycling to middle-income countries poses the opposite problem to that of low-income countries in terms of allocation insofar as the absorption capacity is *a priori* much greater than the amount of SDRs that can potentially be recycled. The characteristics of the facilities provided by the Resilience and Sustainability Fund make it possible to arbitrate between these different imperatives: they are eligible for lower middle-income countries, their interest rate varies according to the income category of the beneficiary countries (which minimises the need for concessional resources for middle-income countries) and, while they remain proportional to the quota, they are capped at SDR 1 billion. The success of this fund, which has mobilised more than SDR 30 billion and granted financing to 18 countries (at the end of March 2024, i.e., 18 months after the start of its operational implementation), may make the need to seek new recycling channels less pressing.

Neither the IMF channel nor that of the multilateral development banks meets the criterion of country vulnerability for the allocation of their financing as these institutions' procedures stand. The Poverty Reduction and Growth Facility, which in the past has already been replenished by SDRs and which is the easiest and most popular option for recycling them, has the merit of focusing loans on low-income countries, but although this rule has recently been relaxed somewhat, it does not take into account the vulnerability of countries in the amount allocated because this is limited by each country's quota.[60] As for the IDA and the ADF, which also focus on low-income countries, their grants and loans are based on a geographical allocation formula that, alongside gross national income (GNI) per capita, gives predominant weight to a country's 'performance', that is, the quality of its economic policy as assessed by these same institutions without really taking account of its structural handicaps.

The channels envisaged largely pre-empt conditionality. By financing the PRGF or the Resilience and Sustainability Fund, recycled SDRs automatically fall within the logic of the conditionalities of IMF facilities whether they are backed by economic policy programmes negotiated with governments but which are binding or whether they are very light in the context of the rapid credit facility. However,

60. However, the IMF's intervention to prevent or deal with a balance of payments crisis can be seen as taking into account a form of vulnerability.

these facilities have the advantage of constituting 'budgetary aid' and thus correspond well to the purpose of recycling, which is to open up the fiscal space of the recipient countries. The same might not be true of a reallocation via the World Bank or the African Development Bank insofar as these banks give priority to aid for projects or sectoral policies that give rise to specific expenditures, for example, if it is a question of extending vaccinations or improving health systems or taking action to mitigate or adapt to climate change. Whatever the intrinsic usefulness of such expenditure, targeting the use of SDRs to it means abandoning its original purpose. It is public finance management as a whole that determines the balance of payments and the need for foreign exchange reserves. Spending aimed at transforming the economy and making it more resilient to climate change must be part of an overall vision of public finances that allows for a comparative analysis of the appropriateness of spending and taxes. This is the reason it would be advisable, at the very least, to ensure that this targeted spending is in line with the development policy of the recipient country in order to respect the commitment made in the Paris Declaration on Aid Effectiveness regarding the alignment of donors with the priorities of assisted countries. The same criticism applies *mutatis mutandi* to the Resilience and Sustainability Facility, even though it is budget support.

Does this mean that we should abandon the idea that recycled SDRs should be used to finance the pooling of expenditures on the management of a global public good, which should be accompanied by the creation of cross-cutting funds? This would be a way, for example, of avoiding trade-offs between financing development and the energy transition when financing coal- or oil-fired power generation capacity that is the cheapest solution for development but is detrimental to the overall objectives of the energy transition. These cross-cutting funds would make it possible to finance the difference.

Conclusion

Redistributing SDRs according to the relative vulnerability of developing countries requires coordinated action by donors. The simplest solution would be (would have been?) to channel them through a single fund managed by the IMF. However, if several mechanisms or multilateral institutions were to be used, each mechanism or multilateral institution in charge of allocating SDRs or their counterpart would have to consider the degree of vulnerability of the countries concerned, which would mean adapting the allocation rules of both the IMF and the Development Banks and ensuring that certain countries were not left out.

The recycling of SDRs for the benefit of the most vulnerable countries could also be accompanied by lighter conditionality, focusing on compliance with the rules on transparency and the fight against corruption, and more generally on the long-term transformation of economies, making it possible to reduce their structural vulnerabilities and/or better reconcile the management of global public goods with the imperatives of development. Conditionality would thus make it possible to reduce the 'tragedy of horizons'. It would also be a way of ensuring that recycled SDRs add up rather than substitute for official development assistance efforts.

Proposal 8

Build a consensus on a priority support to the sustainable emergence of entrepreneurs in poor and fragile countries.

Three Essential Avenues for the Development Agenda Over the Next 30 Years*

Jean-Michel Severino

On 22 May 2023, an exciting day of debate was organised by Ferdi's 'International Architecture of Development Finance ' and 'Impact Investment' chairs. It brought together approximately twenty African and international researchers, investors, entrepreneurs and heads of development institutions. What can we learn from this work?

The current debate on the architecture of international financing is putting the question of the contribution of the private sector and private financing to the back centre stage of development.

Whichever way you look at it, if we are to meet the challenges of the coming decades, the rate of investment needs to increase. This is especially the case in poor and fragile countries, which are the focus of everyone's attention. There are two reasons for this: first, their demographic growth, with its implications for education, health, regional amenities, mobility and the response to social challenges; and second, climate change, which has the particular challenge of adaptation. Obviously, public investment will be essential, as will official development assistance. But private investment must also grow; so must private funding.

In practice, there are at least three different sets of subjects.

First, it is desirable for governments in poor and fragile countries to obtain more financing from banks and markets in a sound and responsible manner. The current period is witnessing a growing risk of over-indebtedness, particularly in Africa. It is vital to revisit this issue. Setting up a common, global debt coordination

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mechanism is a key issue as is strengthening the IMF's surveillance capacity. The G20 'common framework' is the first step in this politically complex process.

Second, it is also desirable for more foreign direct investment to be directed towards these same countries. The need for infrastructure is a priority: The domestic private sector, both productive and financial, is rarely on a par with the complexity and scale of operations, even if it can make progress. The key is at the level of the countries themselves; we need better national policies and more projects. This is the reason the most appropriate recommendations concern how to improve the former by enabling them to be more welcoming to private investors, and in the case of the latter, how to strengthen the capacities of the administrations. Development institutions can become more proactive in helping projects get off the ground. International investors need to be reassured about sovereign risks: access to guarantee instruments (such as MIGA, the Multilateral Investment Guarantee Agency) needs to be improved, and public institutions that finance the private sector (also called development finance institutions or DFIs) need to be quicker and more effective partners.

Third, strengthening the entrepreneurial emergence and growth of small- and medium-sized enterprises in these poor and fragile countries is a top priority. Whatever aid and guarantees may be available to large international companies or institutional investors, these countries are too small and too complex to be of any interest to them other than on the margins. Unlike in the case of infrastructure, the focus should be on the local private sector. This sector is weak, fragile and very small.

It is possible to strengthen the entrepreneurial dynamic in poor countries. Twenty years of experiments and pilots have produced some convincing experiences in a context in which the will to undertake is quite strong. There is no shortage of projects here!

So today's agenda is one of scaling up. First, we need to support startups by strengthening acceleration, incubation and pre-investment schemes. Second, we need to set up private funds or private investment companies in as many countries as possible to provide long-term capital and capacity building for small businesses in the process of being structured. Third, regional funds are needed to finance the expansion and capital strengthening of companies that become too large to be financed at the national level but cannot yet access, for example, commercial investment funds. At all levels, technological and managerial capacity building is essential.

However, there are two important points in this agenda that are too often underestimated.

First, national savings are still too low to be able to finance this capital investment effort. Furthermore, as we have said, international savings cannot be easily mobilised in the direction of these companies. We need public, national and international financiers to supplement national private investment. This is the reason the mobilisation of the famous DFIs as well as public aid agencies is essential.

Second, even if the private companies that are financed are highly profitable and provide considerable societal value, investors in this field can rarely achieve levels of return that correspond to market expectations. For example, it is difficult to value small African companies at levels equivalent to those of their European sisters. Investments in these small companies are also burdened by high management costs and sometimes heavy taxation and exchange rate losses, not to mention a claims experience that takes its toll on results, even though it is not very high. Therefore, public investors must accept low financial returns, which are justified by the high fiscal and social returns. If they want to attract private investors, they must also agree to provide them with guarantees or other return-enhancing elements.

Thus, this agenda has a budgetary cost. But as various studies have shown, this cost is modest in relation to gross domestic product (GDP) and the societal benefits generated. The DFIs, for example, still need to have the capacity to support this effort. Until now, this has not been their mandate. It must become a mandate, and their economic model must enable them to support it. It is up to their public shareholders, that is, the governments of the OECD and China, to act in this direction. Aid agencies also need to accept the idea of committing public funds to the productive sector. This is a major ideological and sometimes know-how barrier for some of them to overcome. We need to invest in the conceptual framework and the economic and impact justification to reassure and convince them.

There are very few large and medium-sized enterprises in Africa. Most of the large African companies of 2050 are not yet born. Accelerating their birth, reducing their losses during their growth period and making their expansion faster, safer and more environmentally and socially sustainable: This is the major development agenda for poor and vulnerable countries over the next thirty years. It will create the mass of jobs needed to absorb the huge demographic wave ahead of us, which is both a challenge and an opportunity. This is how we will create the financial markets of tomorrow and how the major international investors will turn to these countries that are still poor but will be less fragile in the future if this agenda succeeds.

A final word. International society must become more coherent. If we want major companies and global financial markets to connect with developing countries, the right hand of OECD countries that wants to help them must act in the same direction as their left hand, which governs the financial markets. Yet we are seeing an accumulation of rules on anti-money laundering, anti-terrorism, banking risk management, ethics and the environment that are beginning to raise questions. Regardless of how positive and undeniable their inspiration may be, they are leading to a level of compliance risk that is turning too many leading international companies away from developing countries, especially the poorest ones. It is essential to return to greater consistency, to find the right methods and the right compromises between the desire, on the one hand, to clean up the financial markets and make them more stable and, on the other hand, to promote investment in the most fragile areas of the world.

Proposal 9

Reverse under-investment in the agriculture of poor and vulnerable countries.

Seven Proposals to Support and Finance the Agricultural Sector in Sub-Saharan Africa in the Context of Climate Change*

Alain de Janvry, Elisabeth Sadoulet

Summary of the Argument

In this paper, we present a theory of change to address underinvestment in agriculture and, hence, potential income losses as well as losses and damages caused by climate change in sub-Saharan Africa. The starting point is a marked under-investment in agriculture compared with the recommendations of the Comprehensive Africa Agriculture Development Program (CAADEP) of the African Union Development Agency (NEPAD). This lack of investment is holding back the technological progress needed to improve productivity and climate resilience, which are crucial to achieving the SDGs.

In addition, the losses and damage caused by climate change will become so great that they are likely to have devastating consequences for the wellbeing of populations, the social stability of states and international emigration. Faced with this, the international community is proposing to follow the suggestion made by Mia Mottley, Prime Minister of Barbados, in 2023 at COP 27 to mobilise considerable resources to mitigate these impacts, mainly through two methods: ex-post compensatory transfers and the creation of more resilient ex-ante incomes by adapting agriculture to climate change.

The approach presented is based on a conceptual framework that advocates consolidating the assets of small farmers, achieving the green revolution in field crops, transforming agriculture towards high-value-added plant and animal products, investing in rural transformation for the development of local non-agricultural businesses and eventually achieving structural transformation based in

* Summary of the Working Paper: De Janvry A., Sadoulet E. (2023) "Seven Propositions to Support and finance the Agricultural Sector in Sub-Saharan Africa in the Context of Climate Change", FERDI *Working Paper* P324.

cities. This strategy requires careful planning and the collaboration of international development finance institutions.

To support these efforts, the document proposes seven essential public investments: developing planning capacity, consolidating land property rights, investing in agricultural research and development (R&D) adapted to the region, improving the response to climate shocks, investing in water management, building inclusive value chains of small farmers to feed cities and linking social protection to climate impacts.

These proposals aim to catalyse the private and public investment in agriculture needed to increase productivity, improve food security and make the sector more resilient in the face of climate change. On the supply side, private finance for these investments can come from modernising rural microfinance and reducing the risk of commercial lending to agriculture. On the demand side, overcoming these challenges will require an increase in demand for credit for investment, ways to manage risk and the development of inclusive farm value chains.

Objective

This note aims to put forward proposals to support and finance agriculture in sub-Saharan Africa, thereby improving its performance and its role in development. It focuses on integrating small-scale farming into local and international value chains to better meet growing urban demand. Inspired by Prime Minister Mia Mottley's initiative, the note advocates the use of significant funds, not only to compensate for the loss and damage caused by climate change but also to invest in adapting agriculture through technological and institutional innovations, strengthening resilience and reducing exposure to climate risks.

Context

In sub-Saharan Africa (SSA), agriculture plays a crucial role in employment, economic growth, food security and the fight against poverty. Despite its importance, the sector suffers from stagnant productivity, growing rural poverty and lagging modernisation. These problems are mainly the result of underinvestment by the public sector, the lack of adoption of new technologies, the slow transition to high value-added crops, insufficient competitiveness in the face of imports and the negative impacts of climate change. Nevertheless, Africa has considerable agricultural potential, thanks to vast unused land and energy resources as well as successful technological and institutional innovations that can be widely disseminated. The current context is also marked by young demographics and rapid urbanisation, which pose both challenges and opportunities for development. Other factors to consider include an increase in poverty, structural transformation hampered by global phenomena, such as robotisation, climate change exacerbating migration, growing insecurity and high public debt.

A Conceptual Framework for Putting Agriculture at the Service of Development

The conceptual framework described aims to analyse and promote economic and social development through agriculture in sub-Saharan Africa based on the rural development model of the International Fund for Agricultural Development (IFAD) developed in collaboration with various international organisations such as the Food and Agricultural Organization (FAO) and the World Bank. This model proposes a structural transformation in several stages, ranging from the consolidation of farmers' productive assets to structural transformation, via the green revolution, agricultural transformation and rural transformation. The success of this transformation requires in-depth planning and coordination to integrate economic, social and environmental considerations, a challenge successfully met in some cases by agricultural transformation agencies in Ethiopia and Rwanda. Inspired by the Chinese experience of agricultural development, which has gone through the same sequence, this framework highlights the importance of adapting to local specificities, including the challenges posed by high population growth, high geospatial heterogeneity, the predominance of peasant agriculture, increased vulnerability to climate change and the impact of food imports on local production. There is also significant underinvestment in agriculture, particularly in research and development, compared with the standards recommended by organisations such as CAADEP, thereby underlining the need for greater commitment to realising the full potential of agriculture for development in sub-Saharan Africa.

Evidence

The diagnosis of the agricultural situation in Sub-Saharan Africa (SSA) follows five key stages of development, which are aimed at formulating recommendations to improve agricultural investment and reduce losses due to climate change. First, the lack of comprehensive property rights over assets such as land and water hinders secure access to resources, investment and conservation. Despite some progress towards land certification, appropriate local governance systems are needed to effectively manage collective ownership, particularly in response to demographic pressure and climate change.

Second, the green revolution remains incomplete in SSA, with yields and the use of chemical fertilisers still much lower than in other regions. Production growth is based on expanding cultivated land rather than improving yields, leading to environmental pressure from deforestation.

Third, the agricultural transformation needed to feed rapidly growing cities is insufficient, leading to growing dependence on food imports, especially in the production and processing of high value-added products, with notable successes in animal products. Challenges include the certification of the quality of peasant production (especially in terms of plant health), market access for high value-added products and the separation with respect to many products of the dynamics of agricultural production and urban consumption.

Fourth, delays in rural transformation limit the diversification of income sources and participation in non-agricultural activities, which are essential if rural poverty is to be reduced without migration to the cities or abroad.

Fifth, development is retarded by a truncated urban structural transformation characterised by early deindustrialisation and low productivity in the urban informal sector. A potential substitute for this is rural transformation in which secondary cities receive non-agricultural rural activities linked to agriculture.

This evidence underlines the importance of institutional innovation and targeted investment in R&D for local agro-ecological conditions, property rights management, and agricultural and rural transformation to meet the challenges of population growth, climate change and import competitiveness.

Financing Private Investment in Small-Scale Farming and Managing Risk

Financing private investment in smallholder agriculture in SSA involves tackling two major challenges: access to credit and risk management. Despite the crucial importance of credit in financing the investments needed for the green revolution and agricultural transformation, farmers face limited access to commercial bank loans, primarily due to a lack of financial collateral and a reluctance to risk land as collateral. Microfinance, while more accessible, suffers from insufficient loan amounts, high costs and rigid repayment terms not suited to the investment needs of agriculture in which investment cycles are long and inflexible.

Studies have shown that even when credit is available, its effect on the use of fertilisers and other essential inputs remains limited, indicating that the credit constraint is not the only barrier to investment. The main barriers include the low profitability of agricultural investments due to the lack of complementary inputs, such as organic soil fertilisation, and high transaction costs on markets. Significant progress has been made in making microfinance credit more responsive to farmers' needs, notably through more flexible repayment terms, the possibility of using purchased assets (animals, machinery) as collateral and access to innovative public–private financial products that reduce the risk for the private component.

Risk management is essential, notably through technological innovations producing more resilient cropping systems, index-based insurance against climate shocks, pre-approved credit lines indexed to climatic events to enable a rapid response to losses and damage and the development of irrigation to mitigate the impact of water variation. Although theoretically effective, it is a struggle for these solutions to be adopted on a large scale, partly because of farmers' misperception of risk, which they underestimate, their lack of understanding of insurance products, particularly the index approach with its basic risk, and insufficient investment in irrigation facilities.

To encourage investment in smallholder agriculture, it is crucial to combine improved access to credit with effective risk management strategies that are adapted to local conditions and supported at least by temporary subsidies and training sessions to increase understanding of the strategies by potential users. These efforts should be complemented by increased investment in research and development for Africa's specific agro-ecological conditions to overcome the challenges of profitability and adoption of agricultural technologies.

From Positive Diagnosis to Standard-Setting Proposals

The diagnosis of the agricultural situation in SSA reveals public and private underinvestment, not due to a lack of understanding of the potential of agriculture for development, but rather to disappointment about the returns on investment. Challenges include the complexity of managing agricultural investment, the potential diversion of public spending to private interests, such as subsidies, the time lag between longer investment cycles and shorter political cycles, the political priority given to urban interests, a high unshared risk for private investment, particularly under the prism of climate change, and the cultural and economic idiosyncrasies of peasant agriculture, which often do not benefit from membership in a professional organisation. It is suggested that to revitalise investment in agriculture, we start with successful local initiatives to build political and popular support for long-term investment. This means initially targeting regions that are relatively more resource rich and already more integrated into the market and then extending the approach to more difficult regions. Multilateral development institutions are encouraged to adopt this framework to promote agriculture as a lever for development in the context of climate change, paving the way for ex ante mitigation of climate loss and damage.

Seven Proposals to Support and Finance the Role of Agriculture in Development in the Context of Climate Change

The conceptual framework for revitalising agriculture in SSA suggests seven strategic investments to support agricultural development in the face of climate change.

1. Developing planning capacity: It is essential to develop coordinated investment strategies that take account of geographical diversity and integrate the dimensions of productivity, poverty and sustainability.

2. Consolidate property rights: Formalising property rights is crucial to encouraging multiyear investment and facilitating access to capital.

3. Invest in R&D: A greater commitment to R&D is needed to develop technologies adapted to local conditions, thereby increasing profitability and the adoption of new farming practices.

4. Managing climate risk: Public support for innovative tools such as index insurance and resilient technologies can help reduce the negative impact of climate change on investment and modernisation decisions.

5. Invest in water management: Irrigation plays a key role in increasing yields, introducing high-value crops for agricultural processing and reducing climate risks.

6. Building modern and inclusive value chains: Investment in commercial infrastructure and contracts that promote access to urban markets are essential to connect farmers to dynamic and resource-rich value chains.

7. Use indexed social protection: Parametric social transfers can offer a rapid response to the losses and damage caused by climate change as a complement to agricultural recovery. They can include a temporary job guarantee for the poorest and the construction or reconstruction of local infrastructure.

These investments vary in terms of public and private benefits and require a combination of international aid and public and private expenditure. Public investment is vital to catalyse private investment, particularly in the poorest countries where budgetary constraints require additional international support. These proposals offer a basis for prioritising investment in agriculture adapted to climate change in line with the historical responsibility of industrialised countries and the SDGs. All this is in anticipation of future reforms of multilateral development institutions to meet the massive financing needs to implement them.

Proposal 10

Strengthen the effectiveness of budget support by enhancing country ownership.

What Should Be Done about Conditionality?*

Matthieu Boussichas, Patrick Guillaumont,
Sylviane Guillaumont Jeanneney

The debate on conditionality has been taking place for a long time but is now growing: what are the reasons for this and what are the prospects for reform?

The Historical Critique of Conditionality

Time for Adjustment

The academic and political debate on the merits and nature of conditionality in official development assistance (ODA) was particularly intense in the 1980s and 1990s, when adjustment programmes were proliferating, whether sponsored by the International Monetary Fund, the World Bank or bilateral aid. The debate on structural adjustment programmes was particularly lively. CERDI and FERDI contributed to this debate through numerous reports and publications, either of a general nature or applied to specific African countries, notably on the possibility of moving from instrument-based conditionality to results-based conditionality, which will be discussed below. The main point of the debate was the interference of Western donors in the policy choices of countries and the underlying assumption that donors know better than the countries themselves what to do – or are at least freer to say or recommend it than country officials. Over the years, this interference has become less tolerated, while the competence of the elites in the recipient countries has increased and nationalist feelings have been exacerbated, either by recurrent events or by global geopolitics.

From the Aid Effectiveness Forum to the Busan Forum

In 2005, the OECD Development Assistance Committee's Forum on Aid Effectiveness adopted the Paris Declaration, which advocated the principle of alignment with the priorities of recipient countries and the ownership of policy instruments

* Guillaumont P., Boussichas M., Guillaumont Jeanneney S. (2024) "Que faire de la conditionnalité ?", FERDI *Policy Brief* B266.

by those countries. The Paris Declaration, the implementation of which has been the subject of various evaluations, has regularly been repeated in official speeches and documents, though it is far from being fully and generally applied. The Busan Forum that followed in 2011 adopted the new name of "Global Partnership for Effective Development Co-operation", supported by both the OECD and the UNDP, and reaffirmed the principles of the 2005 Paris Declaration, which seemed to augur a real change in aid practice.

Conditionality Undermined by the Change in the Political Environment

Two main categories of international and national factors, the importance of which was recently assessed by Ferdi (Guillaumont, Boussichas and Dsouza, 2023), appear to have undermined the principles of conditionality over the last ten years and significantly influenced its implementation.

Chinese "Non-conditionality"

Among the international factors, one is naturally the growth in Chinese aid, particularly in Africa, which has been provided without Western-style conditionality. It is clear that Chinese aid, despite having freed itself from traditional conditionalities, involves other costs and other constraints, which may gradually reduce the appeal of an apparent lack of conditionality. The impact of this apparent lack of conditionality in Chinese aid on the conditionality of Western aid remains to be assessed. It does seem that Western conditionality has been relaxed where Chinese aid was the most important (Hernandez, 2017; Maroof, 2020; Watkins, 2021).

Universal Objectives

Another important factor in the change in thinking was the adoption, in 2000, of the Millennium Development Goals (MDGs) and then, in 2015, of the Sustainable Development Goals (SDGs). One might have assumed that reference to these universal goals would have encouraged the expansion of goal-based, rather than instrument-based, conditionality, but the practice of aid agencies, the pressure of their bureaucracies and the public opinion in developed countries have led to its goals (and the 169 targets that have accompanied them since 2015) being used as arguments for maintaining a relatively detailed conditionality that, in the end, comes closer to the instrument-based conditionality from which it was difficult to break away. This is how conditionality linked to climate impacts or gender equality has taken refuge behind the SDGs, undeniably introducing a new form of interference, felt as such and sometimes vigorously criticised by the recipient countries. Admittedly, nationally determined programmes to reduce CO_2 emissions seem to be based on the principle of ownership, but this new context has not necessarily encouraged respect for the principle of alignment.

Fragile or Authoritarian States

It is more difficult to assess and deal with the internal political factors that have influenced the practice of conditionality. In this respect, a distinction must be made between what has been called, on the one hand, the fragility of the state and what has been called, on the other, the authoritarian nature of the regimes. Fragile states and autocratic regimes are two different political realities, but they cause fairly similar problems for conditionality because of the strong suspicion that they arouse in donors about the behaviour of recipient governments. Whatever doubts there may be about the concept of fragile states, the fact is that, since the beginning of the 21st century, situations of political fragility have multiplied and deteriorated, particularly in Africa. State fragility, when manifested in internal violence, ineffective public services or endemic corruption, has naturally led to a greater desire on the part of donors to condition the use of resources made available to governments. Another reaction has been to bypass the state itself by funding structures that are independent of it and supposedly better controlled but that play a growing role that has also contributed to the weakening of the state. In addition, conditionality has been extended in various ways to cover issues such as human rights, and its scope has been widened to include democracy and governance, posing a particular problem for authoritarian regimes. Conditions can become formal or virtual until one day, when a threshold of poor governance is crossed, cooperation is suspended altogether. As the threshold of intolerance is discretionary, it has in fact been applied unfairly: more rigorously to countries of little economic and political weight than to the big emerging countries and the good economic performers. "Double standards" have thus become a new criticism of conditionality. Faced with fragile states and poor governance, donors have had to look for a solution in two directions: increase political conditionality, but in an apparently ineffective way, or implement measures to monitor the destination of flows.

The above factors, fragility in particular, call into question not only the logic and practice of conditionality but also the criteria for the international allocation of concessional resources – another important issue that aid policies have to address (Guillaumont, Guillaumont Jeanneney and Wagner, 2020; Guillaumont, 2023). Multilateral development banks allocate their concessional funds on the basis of allocation formulas that, more often than not, give considerable weight to the quality of the policies pursued by the assisted countries (so-called "performance"), judged on a discretionary basis. This practice is intended to guarantee the effectiveness of aid but constitutes another form of interference. What is more, since the result has been to exclude fragile or conflict-affected countries – precisely those most in need of aid – from allocations, special windows have been created for the benefit of these countries, with a specific and often more fussy application of conditionality. The two issues of allocation criteria and conditions cannot be addressed independently. Finally, allocation criteria and conditionality must together be made coherent in the way in which they take the SDGs, fragility and vulnerability into account.

What are the Avenues for Reform?

What then are the ways of improving the practice of conditionality, bearing in mind that donors cannot totally abandon it and that recipient countries are finding it increasingly difficult to handle? Four avenues, none of which is completely new, seem to need to be pursued, clarified and strengthened.

Macroeconomic Conditionality: Alignment with the IMF

As regards macroeconomic conditionality, which has been the responsibility of the IMF for more than half a century in its support for balance of payments adjustment, it is inconsistent for other donors because they wish to provide budgetary support and to impose macroeconomic conditionality that diverges from that of the Monetary Fund. In the glorious days of adjustment, the practice was for the European Union, or even France, to provide budgetary aid only if the country had signed an agreement with the IMF. This does not mean that, under the guise of budgetary aid, donors cannot finance and influence fiscal policy reform, for example. However, these are two different things: one is to subject overall budgetary aid to conditions that are likely to improve the budget balance; and the other is to finance a study or technical cooperation mission in the tax field, the conclusions of which could eventually be used to devise a political decision for the country, which it could put forward in its negotiations with the Fund. The Fund's major responsibility in the macroeconomic field, which is in line with its purpose and the competencies that lie within it, is all the more justified in that it has been able to adapt its doctrine to changing ideas and circumstances (Cabrillac and Jacolin, 2022).

Results-Based Conditionality for Sectoral Aid

The second approach, which is particularly relevant to sectoral aid (education, health, etc.) that is likely to be renewed or continued over a medium or long period, is to make its continuation conditional on the achievement of results (Collier, Guillaumont, Guillaumont Jeanneney and Gunning, 1997). Its essential advantage is that it gives countries full freedom and responsibility to choose the measures or instruments that they will implement to achieve these results. As far as possible, results should be assessed in terms of impact rather than being measured by indicators of intermediate variables, whether output or even outcome indicators. For example, attendance at health centres is not an end result: only the reduction in mortality or morbidity represents a final impact. This reduction, particularly in infant and child mortality, can be assessed through DHS-type surveys, which are no more costly than maintaining an external, fussy bureaucracy of which the purpose is to monitor, check, influence and steer the implementation of the measures selected as a condition for disbursement.

Obviously, it remains to be seen whether these results take into account the role of exogenous factors that are independent of a country's policy. The burden of proving exogeneity certainly lies with the recipient country, while the assessment of its impact rests with the funding source. This implies a consensus on the method to be adopted and the reallocation of these funding sources' staff, who will have to be less ill-accepted prescribers than evaluators.

Operational Conditionality

The third approach, which applies to fairly large-scale operations, can be described as operational: it involves one or more conditions, the implementation of which is directly necessary for the success of the project financed. In the case of an energy supply project, the condition may be the adoption of a tariff policy. The condition is then the operational standard. It is legitimate and acceptable if the standard imposed by the donor to finance the project does not constitute a macroeconomic policy choice when the country could legitimately prefer a different approach. The project leader must then be able to justify rigorously that the condition concerning the standard is the only one that can ensure the success of the project.

Traceability

The fourth way, which corresponds to a general demand from public opinion and especially from the parliaments of the countries providing aid, is that the destination of disbursements should be subject to rigorous verification. Traceability of aid flows is obviously desirable to avoid misappropriation, corruption and so on, but it is unevenly easy. It is very difficult for budgetary aid, but then it is up to the Monetary Fund to perform as much monitoring as it can. It is easier for specific, clearly identifiable projects but obviously implies the power of investigation and therefore the cooperation of the operator's country.

The Red Line

Traceability is particularly important in the most fragile countries but also in countries that are not fragile but that have authoritarian and opaque management. The political problem posed by dictatorial regimes is knowing what red line they must not cross in terms of human rights, in particular to ensure that the State remains a recipient of external public funds. There is a debate about the legitimacy of the new political conditionality, such as that which the EU is trying to promote through societal norms inspired by European standards (for example, LGBT rights). The trade-off between standards specific to certain civilisations and universal standards is particularly delicate.

However, even if the red line is crossed and donors decide to stop all support for these countries, this should not prevent the continuation of decentralised actions or support for local NGOs, provided that these actions can be carried out with sufficient security and that they consist of donations and do not involve the State in repayment. Of course, we must ensure that local people do not suffer a double penalty as a result of the State's behaviour on the one hand and the withdrawal of donors on the other.

In conclusion, in the current geopolitical situation, in which the West's policy towards the global South is increasingly contested, we need to reflect on the legitimacy of conditionality.

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Aid Effectiveness: How Has the Literature Evolved Over the Last Two Decades?*

Lisa Chauvet, Marin Ferry

Historical Background

The debate on the effectiveness of international aid, a controversial subject from the outset, took a particular turn in the 1980s with the formulation of the micro–macro paradox by Mosley (1987). This paradox highlights the contrast between the positive assessment of individual aid projects and the lack of consensus as to whether they have a positive impact on a country's economic growth. The end of the Cold War intensified interest in this issue, particularly with the reduction in aid in the 1990s and criticism of the system of conditionalities. These conditionalities, which were imposed by the Bretton Woods institutions, were seen as inconsistent with international pressure for greater democracy and accountability in developing countries.

Discussions in the 2000s focused on two main aspects. The first concerns the factors favouring a positive impact of aid on growth. The study by Burnside and Dollar (2000) suggested that aid is more effective in countries with good economic governance, defined as favouring trade liberalism and promoting fiscal and monetary orthodoxy. Other studies, such as those by Boone (1996) and Kosack (2003), have argued that political institutions, particularly in democratic countries, are crucial to ensuring that aid is used effectively since in autocratic regimes, aid can be misappropriated by kleptocratic elites. Wright (2008) observed that the effectiveness of aid when autocrats govern recipient countries is all the weaker because their future is uncertain. Finally, aid has been shown to be more effective in countries facing external shocks (Guillaumont & Chauvet, 2001; Collier & Dehn, 2001; Chauvet & Guillaumont, 2009) and in post-conflict situations where it can compensate for the weakness of government responses (Collier & Hoeffler, 2004).

* Summary of the Working Paper: Chauvet L., Ferry M. (2023) "L'efficacité de l'aide : quelles évolutions de la littérature depuis deux décennies ?", FERDI *Working Paper* P329.

These results have fuelled reflection on the allocation of aid. The idea of more selective aid that targets countries where it is most effective emerged in the wake of the Burnside and Dollar study. Collier and Dollar (2001, 2002) proposed an allocation based on performance, while Cogneau and Naudet (2007) suggested an approach based on equal opportunities, targeting countries with major structural handicaps. Based on their previous work, Guillaumont et al. (2017) and Guillaumont et al. (2023) defended the importance of structural vulnerability to external shocks as an allocation criterion, both for reasons of efficiency and reasons of justice, with vulnerability taken as a structural handicap.

Alongside these discussions on the conditions for aid effectiveness, many others have challenged the scientific approach of the studies. A number of studies have been criticised for their methodological weaknesses, specifically in relation to the composition of the sample or their unconvincing treatment of the endogeneity of aid. New studies are appearing that seek to improve the estimation of the causal effect of aid on growth, in particular, by focusing on groups of countries with similar characteristics.

The advent of large microeconomic databases in the mid- and late 2010s has encouraged the emergence of a new generation of studies on aid effectiveness, which focuses on macro–micro or purely microeconomic approaches. These studies provide a better understanding of the heterogeneous effects of aid and identify the channels through which the aid supports the economic and social development of recipient countries, thereby going beyond the simple measurement of growth.

Taking a Closer Look: the Contribution of Microeconomic Data

The rise of microeconomic surveys (households, businesses, individuals) and satellite data is revolutionising the study of the effectiveness of official development assistance, thanks to a more detailed analysis of economic behaviour in recipient countries.

These new data make it possible to go beyond economic growth to assess the effectiveness of aid and to consider new indicators. Household surveys, such as the Demographic and Health Surveys and the Afrobarometer surveys, have been increasingly used in the literature on aid effectiveness since the mid-2000s. They provide representative data on living conditions, health and household perceptions and attitudes towards institutions and democracy in a wide range of aid-recipient countries. There are also the World Bank Enterprise Surveys that were launched in the early 2000s and provide detailed information on enterprises in developing countries. These sources give rise to new studies that enrich our understanding of the microeconomic impacts of aid, particularly on populations and the private sector.

These new data also make it possible to measure aid at sectoral and spatial levels. Data from the Development Assistance Committee improved significantly from 1995 onwards, enabling more precise studies of aid effectiveness by sector and project. In addition, initiatives like that of the AidData research centre geo-reference aid projects provide a much more rigorous assessment of the local impact of development aid. Historically, China financed these data-targeted projects. They were subsequently extended to other donors, such as the World Bank and India, and for some countries, to all donor countries.

The use of geo-referenced data is revolutionising the assessment of aid effectiveness because it facilitates more detailed analyses of its effect and also (and above all) helps to overcome traditional methodological difficulties by identifying the causal impact of aid on development. The data make it possible to examine the effectiveness of aid at the local level by focusing on specific areas or groups and to assess the impact of aid in relation to more appropriate units of control. These data are particularly useful for studying the heterogeneous effects of aid and identifying specific mechanisms by which this funding influences economic and social development. However, there are limits to the use of this type of data, as only World Bank and Chinese projects are geo-referenced and they do not capture aid in the form of budget support, which remains important for many developing countries.

Aid Effectiveness in the Light of New Data and Methodological Innovations

These data and methodological innovations provide new empirical evidence on the effectiveness of aid, particularly at a subnational level, with a clearer distinction between sectors and agents as well as donors.

Aid and Subnational Growth

The use of nighttime light intensity data and geo-referenced aid, for example, makes it possible to re-examine the aid–growth relationship at a subnational level. However, studies such as those by Dreher and Lohmann (2015) found no clear causal link between aid and short-term growth. Dreher and Lohmann attributed this lack of impact to the fact that these geo-referenced aid data represent only a small fraction of total aid. Civelli et al. (2018) focused on Uganda to study the long-term impact of aid. Their results suggest a positive and significant effect of aid on the growth of nighttime luminosity at regional and departmental levels, underlining the lasting impact of aid in the Ugandan context.

Microeconomic analysis of the aid-growth relationship

Business survey data (World Bank Enterprise Surveys) also indicate that aid accelerates the development of the formal private sector, an engine of growth in many recipient countries (Chauvet and Ehrhart, 2018). Additionally, companies that are structurally more dependent on infrastructure seem to benefit more from aid, particularly in the energy and transport sectors. Ndikumana (2022) also identified positive effects of aid to the manufacturing sector in Africa between 2000 and 2013, highlighting as well the non-negligible impact of aid on services and infrastructure.

Donor heterogeneity: China under scrutiny

Finally, numerous studies have examined the effectiveness of Chinese aid, which is often criticised for its political and economic motivations. However, these studies have concluded that Chinese aid has a positive impact on the economic growth of recipient countries (Mandon & Woldemichael, 2022; Xu et al., 2020; Dreher et al., 2021), mainly through the financing of infrastructure and connectivity projects (Xu et al., 2020; Marchesi et al., 2021).

Although Chinese aid is sometimes used for political purposes by recipient governments, this does not seem to reduce its effectiveness in terms of local development. New data (currently being harmonised) on emerging donors is also paving the way for research into the aid effectiveness of donors such as India, Russia and Brazil that diverge from the principles of the OECD's Development Assistance Committee.

In short, the effectiveness of development aid is complex and heterogeneous, depending not only on the beneficiaries but also on the donors and the methods used to measure its impact.

Beyond Growth

The new studies on aid effectiveness also attempt to go beyond the limitations of previous studies by considering the effect of this funding on measures other than economic growth. More specifically, they focus on three major aspects: human development, the governance of recipient countries and the fight against climate change, subjects that have gained in importance following the adoption of the MDGs in 2000 and the SDGs in 2015.

Impact of aid on human development

Studies using more disaggregated approaches and geo-referenced data validate past macroeconomic analyses and show that aid, particularly in the health and education sectors, has a positive impact on various human development indicators. For example, aid for health has helped to reduce infant mortality, HIV prevalence and improve maternal and reproductive health. Similar results have been observed for education, with an increase in enrolment rates, especially at elementary levels. However, these studies also highlight the need to improve the quality of educational provision. (See the review of work on the effectiveness of aid in reducing poverty and in a context of vulnerability carried out ten years ago by Guillaumont and Wagner, 2014.)

Impact of aid on governance in recipient countries

Recent studies have also looked at the effect of aid on the relationship between states and their citizens, particularly in the African context. Data such as the Afrobarometer is being used to assess the impact of aid on people's perceptions of institutions and their support for those in power. Although the results are mixed, some studies suggest that aid strengthens political support for incumbent leaders, while others point to a negative impact on the fight against corruption and on confidence in national institutions.

Aid as a tool in the fight against climate change

Finally, the question of the effectiveness of aid as an instrument in the fight against climate change has also gained momentum in recent years. A number of studies have examined the effects of climate aid on reducing greenhouse gas emissions and promoting renewable energies. While the results are varied, some research seems to indicate that climate aid has a positive impact on the reduction of greenhouse gases, especially when the projects are specifically aimed at this objective. Other studies raise concerns about the possible indirect effects of aid on biodiversity and forest cover, although these negative impacts are not systematically confirmed. Recent analyses also explore the microeconomic effects of climate aid, such as reducing energy poverty and improving access to electricity, particularly in rural communities in sub-Saharan Africa.

These analyses of aid effectiveness go beyond simply assessing the impact of these flows on economic growth. While the consensus is still fragile, the literature agrees that aid affects different aspects of human, societal and environmental development. These studies reveal the complexity of the impact of aid, which varies according to the type of aid, the sector targeted and the specific characteristics of the recipient countries.

Conclusion

The debate on the effectiveness of international aid is progressing but remains open, not least because of the 'unintended consequences' or 'collateral damage' that may be induced by aid. Although aid appears to improve children's health, education and accessibility via infrastructure and to reduce greenhouse gas emissions, it can also unintentionally support corrupt governments or distort competition in the markets. Future analyses will need to take better account of these unexpected effects by using new methods of analysis, such as textual analysis, to better understand the political economy of aid, particularly in the climate field.

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The Effectiveness of Development Financing
A Practitioner's Perspective…*

Olivier Lafourcade

The work of the Architecture of International Finance Chair has produced a clear observation: the general context of the current system, in terms of its organisation, architecture, operating methods and criteria, procedures, not to mention its aims and objectives, on the part of the various players, public and private, domestic and international, falls far short of expectations.

And we believe that two additional elements deserve attention that may have been underestimated in the past despite a great deal of work, conditionality and effectiveness. The first makes it possible to specify the conditions under which, and how, funding bodies can or should make their contributions. This important subject will be dealt with in a separate document. The second theme, that of effectiveness, is the subject of this short paper. The aim is to find out to what extent the existing development financing system meets clearly expressed needs and the expectations of the main players in this system.

The Theme of Effectiveness

This theme of effectiveness has already been the subject of a great deal of work, and has almost become an unavoidable theme at major international conferences, generally under the heading of "aid effectiveness". This is a matter of constant concern primarily among backers and donors, who are legally required to demonstrate to their constituents the validity of their contributions, whether on a voluntary or for-profit basis. Hence the long-standing emphasis on the link between impact and effectiveness.

* Lafourcade O. (2023) "The Effectiveness of Development Financing. A Practitioner's Perspective...", FERDI *Policy Brief* B248.

In practical terms, then, what are we talking about? Both the literature and the results of international conferences on the subject point to relevant criteria for assessing effectiveness. These are essentially criteria relating to development aid. It seemed useful, if not necessary, to ask a few fundamental questions in order to better inform the debate, and thus to propose answers better adapted to present realities and future challenges.

But what about the beneficiaries? What is their perception of the nature of effectiveness? In terms of what? And at the local level, who is affected? The government? Civil society? There are likely to be very different perceptions depending on who is asked these questions, and we can only conclude that at present there is limited information on this subject, apart from statements tinged with ideology and politics.

Global Financing for Development vs. Financing for Development Aid

On the whole, however, it appears that the issues of effectiveness addressed in international conferences and of concern within the organisations themselves have so far focused primarily on the effectiveness of development aid, rather than on overall financing. This was the case for the meetings in Paris (2005), Accra (2008), Busan (2011) and Addis-Abeba (2015), which were all milestones on the road to improving effectiveness. In this context, the emphasis was placed on the usual dimensions, those defined at the Paris conference: ownership, alignment, harmonisation, results and mutual accountability. Subsequent conferences have added to this, notably in terms of focusing efforts, for example in Accra, on sectoral bases: technology, infrastructure, health, climate change, etc.; as well as an additional emphasis on criteria such as coherence, relevance, efficiency and above all coordination. The Busan conference focused on aid effectiveness, while the Addis Ababa conference dealt with the financing of sustainable development programmes; all perfectly legitimate subjects, but which ultimately deal mainly with donor and funding institutions, in the specific context of development aid.

International meetings held after these conferences attempted to continue the efforts, in particular by trying to integrate some of the "new" players more closely into the traditional official institutional system. China is a case in point. However, after an encouraging start, China has increasingly distanced itself from this "official" environment. We can then note a certain "exhaustion" of the whole process initiated since the Paris Declaration, to the point where we there are doubts about the prospect of arriving at a coherent global system.

If it is about the effectiveness of overall financing for development in countries, not just aid financing, then the main source of this financing, domestic resources, especially public, cannot be ignored. More broadly, addressing this question from a global perspective means taking into account the four sources of funding mentioned above. In this context, it is legitimate to ask how effectively these global resources are being used.

In reality, there are few references to this issue from a more global view of measuring effectiveness, taken as a whole according to the purposes of the funding. Each player or group of players is the subject of analyses and interpretations, but it is not clear where the coherence of the whole lies. In particular, there is a lack of information, analysis and reflection on the effectiveness of private sector development financing.

With regard to the financing of development aid, the question arises again of the need to distinguish between the sources of this financing, and to concern ourselves with the effectiveness of the system of allocation, distribution and distribution between these sources and even within these sources. By way of example, we might ask what guideline, if any, dictates the distribution between several sources of aid funding, namely: (a) multilateral sources, themselves divided between United Nations-type and Bretton Woods-type sources; (b) regional sources such as those of the European Union; and (c) bilateral sources. By way of illustration, consider the French government (Ministry of Finance and/or Ministry of Foreign Affairs); what criteria govern the distribution of resources to these various destinations? And once again, the question arises of how to assess the effectiveness of these different sources of funding?

Finally, when it comes to the distribution of development aid funding, we need to consider the effectiveness of the systems for allocating these resources. This is a key issue that Ferdi has been working hard on for a long time, in particular by linking the issue of resource allocation to the vulnerability criteria of recipient countries. It is clear that this general problem has not yet found a globally acceptable solution within the official development aid apparatus. Notable progress has been made in some institutions (e.g., the African Development Bank), but less so in others.

Basically, the traditional criterion for allocating aid resources has been country performance. There are several reasons why this criterion is no longer acceptable. First, because the criteria used (e.g., the World Bank's Country Policy and Institutional Assessment (CPIA)) are not above suspicion in terms of bias or subjectivity. And second, this principle tends to ignore the fact that those who should receive the most attention, in terms of human and financial resources, are precisely the most fragile and vulnerable countries. It's a bit like squaring the circle, but it's also a question of effectiveness. We recognise that commendable efforts have been made by the official apparatus, notably the World Bank, to better target aid to the most fragile countries, particularly in Africa.

What Levels of Effectiveness?

The concept of effectiveness can be applied at different levels. First and foremost in terms of the impact of development financing interventions on the beneficiaries targeted by these interventions. This is obviously the ultimate goal of the whole exercise, namely how effective is the exercise in reducing the poverty of the ultimate beneficiaries, within the precise framework of a generally recognised objective? Or would the objective be to measure the impact beyond this specific objective? The aim here is to measure the impact according to objective criteria. A great deal of effort is being made in this area, particularly in impact assessment and measurement methodologies, such as those developed and recommended by Esther Duflo, winner of the Nobel Prize in Economics.

At the other extreme, however, effectiveness can and must be assessed at the level of funding sources, as mentioned above. This has been, and continues to be, the subject of numerous studies on the coherence and coordination of funding mechanisms, including those relating to the concept of development aid.

The Middle Ground?

But there is also reason to be concerned about the entire middle ground between these two levels (i.e., between the contributors and the users and beneficiaries). This includes, on the one hand, the instruments used to ensure the transfer and use of funds; and on the other hand, the operating methods and means of the agents and institutions responsible for managing these instruments. On the one hand, there are many partners, both public and private. On the other, there are many instruments and tools of an extremely diverse nature.

As far as the instruments are concerned, we need to distinguish between very different modes of intervention and very different aims.

First, there are projects, which by definition are time-limited, in a context of finite interventions, temporary mobilisation of players, limited investment and operating funding, etc. The project may be part of, or totally independent of, current funding for existing public or private sector programmes. The question here is how to assess the effectiveness of this type of funding. The comparative advantages are well known: the specific nature of the beneficiaries, the targeting of interventions, the control over expenditures and the resources made available, the time dimension, etc. The disadvantages are also well known: the limited duration, the challenge of ensuring the sustainability of interventions and their financing, the risk of disruption or even interruption in management and governance, the risk of frustration on the part of local players when interventions are not followed up, questions about the sustainability of interventions over time, etc.

This issue is particularly relevant to funding from the private not-for-profit sector. Many projects financed and supported by NGOs, foundations and others using concessional resources (donations and grants) experience adequate development, often remarkable in terms of impact, during the investment and development period. But when the project is over, local resources, both human and financial, do not take sufficient responsibility, to the point where the whole intervention is put at risk and can lead to collapse, often resulting in disappointment and recrimination locally. Can we talk about effectiveness in such a context?

Then there is the question of programme funding, which is already based on a broader concept of investment and operation. Unlike the project, the programme is intended to be broader, more inclusive and more sustainable, requiring better institutionalisation, particularly in the areas of programming, monitoring and evaluation, and legitimacy in terms of defining investment and operating expenditure requirements.

This brings us to policy-based lending, sometimes called structural, sectoral or macroeconomic adjustment financing, followed by budget financing. In these cases, it is a question of basing interventions and financing on fully reliable frameworks of competent institutional structures that are capable of defining policies and strategies, and formalising short-, medium- and long-term action plans based on them, with the appropriate intervention instruments in terms of investment and operating financing, based on technical and technological proposals, and with the appropriate means in terms of human resources and governance, etc.

Lastly, we cannot ignore other types of funding, in the form of donations or those granted in return for payment, such as technical assistance and governance support, whether provided by NGOs, foundations, academic circles or others.

In each of these cases, one can legitimately question the effectiveness of the selected instrument. What criteria should be used to measure effectiveness, how should the objective be defined, and what measurement tools should be used? And ultimately, how can we measure the impact on beneficiaries, defined according to what criteria, whether in terms of target populations, results in terms of policy changes or precise references in quantitative or qualitative terms (e.g., the passage of a law or the formalisation of an implementing decree)?

In other words, we might wonder whether we have sufficiently clarified the entire field of intervention instruments to measure their effectiveness.

What Types of Players?
What Types of Service?

We also need to specify and characterise the types of players involved in this whole transfer mechanism. There are four main categories: (a) local government apparatus, including public and semi-public institutions; (b) international public institutions, such as development banks and/or technical assistance institutions, such as specialised United Nations organisations; (c) private for profit institutions, such as companies, with their interventions either in the form of foreign direct investment (FDI) or in the form of commercial financing; and (d) non-profit institutions, foundations, NGOs, etc.

It is also important to consider where effectiveness lies in the set of operational mechanisms that the different modes of development finance are embedded in, namely: (a) strategies; (b) policies; (c) operations; (d) institutions; and (e) governance. The questions in this area remain the same: (a) which criteria; (b) which instruments; (c) which methodology.

Finally, in assessing the effectiveness of funding by external players and partners, we cannot fail to mention the inescapable theme of the behaviour and operation of the institutions concerned, whether public or private.

It is common knowledge that the major development institutions, starting with those of the United Nations, but also the development banks (World Bank, etc.), are subject to well-founded and constantly renewed criticism for their bureaucratic red tape, inertia, complexity, shortcomings and sometimes their incompetence in certain areas. All of this threatens to reduce their effectiveness.

One illustration of this problem is obviously the time lag and the amount of resources transferred between commitments on the one hand and disbursements on the other. How many millions of dollars are tied up and unused simply because of blockages or delays due to bureaucratic and administrative difficulties? As long as 40 years ago, Robert McNamara, President of the World Bank at the time, was quite irritated to learn that a loan proposal for a multi-million dollar project was being delayed because the Bank's duty lawyer was on leave, with no possible replacement.

Similarly, internal procedures designed to guide, supervise and control the mechanisms for awarding contracts, inviting tenders and recruiting expertise are often the cause of complications leading to delays and administrative costs. The application of "safeguards", or precautionary measures, however necessary and legitimate they may be, particularly in the social and environmental fields, is often a source of delays and complications in the examination and processing of investment applications.

Nor can we ignore the difficulties resulting from periodic, if not permanent, internal changes in the administrative structures of the institutions. Thus, the World Bank has gone through multiple reorganisations throughout its history. In each case, the justifications for undertaking such measures can be and are valid. It is often due to the arrival of a new President who, under various influences, thinks that the structures and people in charge need to be changed to revitalise the institution, even before having grasped its nature and the specific ways in which it operates. Yet the consequence of these essentially bureaucratic measures is to create a great deal of uncertainty, at least temporarily, to call into question situations that did not necessarily need to be changed ("if it ain't broke, don't fix it..."), to substitute bureaucratic mechanics for what should be managerial decisions (i.e., in the field of human resources management), and ultimately to contribute to a considerable increase in internal transaction costs.

In assessing how institutions function, we cannot overlook the importance of internal cultures, systems of governance, influences if not political pressures or interference, and in general what are known as "idiosyncrasies", characteristics specific to the institution, all forms of bias and subjectivity that have an impact on efficiency. One example of this is the French influence in the early days of the European Commission, particularly in the directorate responsible for development (DG8 at the time). This influence was called into question with the arrival of the Iberian countries, with a new Latin tropism towards the Mediterranean and Latin America; then a new Germanic tropism with the opening towards the countries of Central Europe. The effectiveness of the entire system cannot remain unaffected in such a context.

The governance cultures of the major institutions are not without reproach in this respect. To caricature somewhat, the United Nations is run by diplomats, often remarkable, but sometimes focused on grand principles and grand strategies that lack operational realism. Development finance institutions are, on the other hand, the meeting place for ministers of finance, planning or budget, whose concerns tend to be how to limit spending and how to mobilise additional resources in the short term. Everywhere, everyone expresses the pious wish for better cooperation between everyone, but often with the caveat of "I agree to coordinate you, but I don't want to be coordinated by you…".

Unfortunately, there are other sources of confusion and inefficiency in the behaviour of inter-institutional governance (i.e., regarding the relations between financing institutions). In many cases, shareholder representatives on the boards of directors are the same, or come from the same national administrations (e.g., between the World Bank and the regional development banks). And yet, it is not uncommon to observe divergent, if not contradictory, attitudes or positions on issues where we might expect common and coherent positions. This is not a source of great effectiveness...

The same could be said of the lack of cooperation, if not antagonism, that can exist between institutions. One can differentiate between the sometimes healthy and necessary competition between development institutions, and the confusion that can result from poorly managed or unmanaged rivalry. For example, in some more advanced countries, the national authorities are very skilful at pitting foreign institutions against each other, or asking them to cooperate on one issue or another; or conversely, to operate entirely separately on certain issues. For example, at one time the Mexican government gave the Inter-American Bank (IDB) responsibility for urban water in Mexico City and the World Bank responsibility for urban and rural water in the rest of the country. On the other hand, it asked the two institutions to work together on issues such as pension and social security reform. We can think of assistance mechanisms for less well-equipped countries to develop similar systems that are more effective.

Moreover, within the institutions themselves, squabbles are commonplace. In the distant past, at the World Bank, the entire agricultural sector was under the influence and control of the British, who had been part of the colonial system, and had exceptional skills based on long experience in the field; irrigation was the preserve of the Israelis and the Americans; while there was a time when the urban water sector was the preserve of the French, who had come from Lyonnaise des Eaux and Générale des Eaux, etc. These concrete examples are not presented as a criticism, since in many cases the results in operational terms turned out to be quite positive. But they serve to illustrate the fact that the effectiveness of the external contribution can depend on very different criteria, which are not always correctly identified.

Finally, we cannot ignore one of the most widespread problems and source of great inefficiency, namely the mechanisms for awarding contracts for goods and services financed by institutions outside the countries, the procurement system. This area is one of the greatest sources of corruption, despite constant efforts and reminders to improve coherence between institutions. Procedures, practices and decision-making are still too often sources of confusion and misappropriation.

These observations, drawn from specific cases in Washington, New York or Brussels, could obviously find their equivalents in other geographies or other institutional frameworks.

In terms of behaviour, we need to look at the skills and behaviour of individuals within institutions, both public and private. We can only note the discrepancy between the behaviour of the "elites" of official development agencies – but also in civil organizations in the "North", including the private sector – largely reflecting the views and practices of advanced Western countries (see the historical weight of American universities in the theoretical formulations of analyses and strategies), and the realities of local development. In this regard, we can cite the excellent work of the sociologist Jean-Pierre Olivier de Sardan ("La Revanche des Contextes" - Ed. Karthala 2021), which highlights the discrepancy between ideas on the one hand and achievements on the other, resulting from insufficient knowledge and consideration of local contexts that are "ignored or underestimated". "It is in the confrontation with local contexts that the fate of any intervention is decided".

New Players?

A new element, adding to the complexity of the whole issue, is adding a little more challenge and perhaps confusion to this situation, and can only invite further reflection. This is, of course, the issue of new entrants, or rather the activity of financial partners who are not part of the traditional institutional ecosystem, in both the public and private sectors. This is primarily China, but also many others such as Russia, India, Turkey, Brazil, etc.

The question in this case is to know how effective these interventions are, but above all, what are the risks of questioning the effectiveness of the entire current system as described above, due to the rise of these new players. The rapid developments in the context of these new players inevitably have implications for the prospects, operating methods and very objectives of the traditional institutional system.

How Effective is the Private Sector?

As a counterpart to the assessment of the effectiveness of the public sector in development finance - and development aid - presented above, the question of assessing the effectiveness of the private sector in this funding is another subject, which is difficult to grasp. Here again, several distinctions need to be made, depending on the sources of the funding (corporate, bank, investment funds, foundations, etc.); the destination of the funding (FDI, trade, operations or speculative); and the form of the funding (loans, grants, guarantees, etc.). It is clear from the outset that, with the exception of a significant proportion of philanthropy, solidarity, social and humanitarian aid, all of which is subject to concessional, non-profit funding from NGOs, foundations, etc., all private sector funding is not intended to finance aid, but to finance development in general. And yet, in many cases, the private sector's contribution to a country's development can be far superior and more effective than many of the interventions known as development aid. How can this effectiveness be measured comparatively?

It is therefore legitimate and necessary to question the effectiveness of each of these modes and means of funding, particularly for comparative purposes. But the answers are not obvious. The literature has dealt with one or other aspect, for example the situation of FDI, which is well documented (see the excellent summary article by Édouard Mien of Ferdi, May 2023). But we don't know of many exercises that address the whole question.

We can, however, rightly confirm a few general lessons, namely FDI's contribution to economic growth, increased productivity and poverty reduction. The contribution of SME development to job creation can be affirmed. Many other benefits confirm the potential effectiveness of private sector financing.

However, it would be extremely useful to take a comprehensive look at the whole issue, by comparing the specific features of the different types of contributions made by the main players in the private sector. This would give a better appreciation of the areas in which promotional actions, changes in strategies and policies, operating methods and regulatory mechanisms could be implemented.

For example, the experiences accumulated by certain impact investment funds over the past 20 years in favour of SME development in Africa are sources of considerable lessons, unfortunately far from being exploited as they could be. This is particularly true of the I&P group (Investisseurs et Partenaires), a true pioneer in the field of financing and supporting small businesses in Africa.

Mechanisms for transferring external funding

The question of where external public funding goes deserves particular attention. The question is whether the funds granted are part of the budgetary process or not in the recipient countries. We are well aware of situations in which this funding is completely separate from the budgetary process, primarily for investments, but also frequently for operating expenditures. This is often the case with the use of trust funds, for which special financial management is required. This subject is closely related to the issue of effectiveness.

The case of Mexico is useful in this respect. In this country, all foreign public funding must go through the government's budgetary mechanism. As a result, external contributions are fully incorporated into the country's budget, both for investment and operating costs.

This means that, at the end-user level, for example the Ministry of Agriculture or the Ministry of Health, no difference can be made between funds from national sources (taxes, customs, etc.) and those from foreign sources. Everything is merged into a single budget. In short, there is no perceived additionality of funding at the level of the application of the funds. This practice corresponds, of course, to an orthodox view of budget management (i.e., a single pool of resources, which are then allocated according to a sectoral distribution process).

This assumes that external contributors have full confidence in the local authorities' ability to manage the budget administratively. Consequently, in practice, the funds allocated to a project by the World Bank cannot be identified by the local development players.

This is an interesting practice in terms of efficiency, but it raises some important questions. If the user (the Ministry of Agriculture) does not see any concrete additionality in its resources due to the presence of the Bank, what incentive does it have to agree to collaborate with the Bank? Apparently all it gets out of it is complications, in terms of various controls, multiple reporting requirements, bureaucratic obligations, application of safeguard procedures, etc.; "all pain and no gain...". Part of the answer may lie in the presumption that the contribution of the Bank's resources to the national budget will increase the budget allocation to its department. In any case, this contribution should ensure the reality and permanence of this allocation, and protect it against arbitrary variations in the application of the budget. In addition, it is to be hoped that there are some benefits to be gained from the Bank's participation in terms of intellectual contribution, the fruits of the Bank's experience in other countries, technical and managerial support, etc.

Certainly, many countries at an advanced stage of budget management are following the same strategy and practices, in line with the IMF's cherished principles of coherence and unity in resource mobilisation. The effectiveness of such a system can certainly be confirmed.

On the other hand, where such a practice is not in place, the risks and dangers are quickly apparent. On the one hand, different budgetary mechanisms than those of the government – is often the requirement of financiers who want to maintain close control over the use of their resources. On the other hand, we can imagine the risks of a multiplication of mechanisms, the creation of parallel systems, depending on the various external players, with as a corollary the risks of different, sometimes contradictory procedures. The effectiveness of such systems is questionable.

Unfortunately, it is not always possible to consider the methodology of non-additionality because, as indicated above, this presupposes competence and reliability in the budget management system which are not always available. But in the interests of efficiency, this is undoubtedly a direction that should be pursued, in particular by accelerating efforts, precisely to improve the quality and performance of budgetary management.

In terms of efficiency, we should bear in mind the risks and dangers associated with all mechanisms that ignore, bypass or undermine national budgetary mechanisms.

Innovation, Risk-Taking? An Effectiveness Criterion?

Who ultimately bears the risk of innovation? The author of these lines recalls a meeting with the Minister of Agriculture of an African country several years ago, during which the Bank announced its decision to terminate an ongoing project on the grounds of non-performance. The Minister, while in no way disputing the fact that the project had failed, pointed out that the same project had been heavily committed to at the Bank's instigation a few years earlier. And his perfectly justified comment was unambiguous: "The World Bank strongly encouraged us to undertake this project, and now you're telling me that it has to be stopped; "But we borrowed from the Bank for this project, and now I have to pay you back...". Moral: be careful not to promote initiatives whose results have not already been demonstrated; in other words, don't make the borrowing country bear the cost of the risk attached to the innovation.

Is this dimension always taken into account? We can of course observe that the form of financing has a decisive influence on this risk assessment; namely a project financed by non-repayable resources (donations, grants) will be preferable in terms of risk-taking to financing in the form of a loan.

Absorptive Capacity

There is another point to be made here, which is undoubtedly a key element in this assessment of the effectiveness of funding. This is the absorption capacity of the countries receiving the funding. And this applies to both public and private funding. It is a question of the local intellectual, physical, administrative and financial capacity to deal with all the issues relating to the transfer of resources. The obstacles and risks associated with this issue are well known, and undoubtedly constitute serious impediments to the effectiveness of the system as a whole.

The multiplicity of players of all kinds, each with its own specific priorities, each demanding access to local leaders, each with its return on investment obligations to its donors, each with its own concerns for visibility and recognition, each with its own operating methods, principles, requirements for monitoring and evaluation, specific reporting measures, etc. All this poses a series of problems for local governance. How many visitors of all kinds should the finance minister of an African country receive, because each delegation must see the minister? What a call for inefficiency when faced with such a situation; excessive constraints on managers' schedules, confusion in the often contradictory messages from representatives, bureaucratic follow-up obligations to satisfy requirements in public and private organisations' distant headquarters, etc.

This problem of dispersed efforts and participants faced with a very limited absorption capacity on the part of local governments (this is as true for private institutions as it is for public funding) points to the need for considerable institutional strengthening. This is a recurring theme that receives a great deal of attention from donors. Of course there is talk about it. Central government departments are building capacity and consultants and advisers are being sent in to boost capacity, but it has to be said that progress is slow and the problem persists, with a few exceptions.

In this respect, it is worth noting and taking as an example the major emerging countries, or countries that already have a high level of institutional capacity and an established political will, but are reluctant to accept any external pressure that is deemed excessive. This is the case in Mexico and other Latin American countries, where the government's attitude is clear and unambiguous: "I am in charge; I only want to see one head…" External partners (World Bank, Inter-American Bank) are obliged to align themselves with the structures and strategies defined by the government. It's quite effective… the question is how to really build capacity in the less well-endowed countries to ensure that they operate effectively at this level.

Combining a Review of Public Spending and an Assessment of Poverty

Whatever their origins, and however they are transferred, whether in the form of global development funding or development aid, public resources from outside the country can only be applied in one of two ways. Either they pass through the country's own budgetary mechanism, or they are applied independently of the local system for managing public resources, as indicated above.

In the first case, where resources are subject to the local public management system, the question of efficiency essentially concerns the measurement of the efficiency of this system. The preferred instrument in this case is the public expenditure review. It is a widely used instrument, particularly in the context of operations by the International Monetary Fund, the World Bank, regional development banks, etc. The effectiveness of how external resources are applied will therefore largely depend on the effectiveness of the local public resource management system. This applies to both capital and operating expenditures.

It is therefore essential to carry out a complete and reliable assessment of the operations, operating methods, monitoring, supervision and evaluation mechanisms of the entire government apparatus in this area. The experience of many concrete cases indicates that there are some reasons to doubt the effectiveness of the use of public expenditure. By way of illustration, the Deputy Minister of Mexico's Ministry of Finance in charge of the budget a few years ago, stated unequivocally: "public spending does not go entirely where it is intended, and only partially reaches the people it should serve." It's not hard to imagine that the same observation applies to many other countries.

In addition, other local sources of information make it possible to define fairly precisely the populations, regions and sectors that should constitute the priorities where public resources should be applied. For example, in the context of the fight to reduce poverty, the poverty assessment document is a remarkably useful tool for helping to formulate development strategies and policies.

The link between a review of public spending and the state of poverty in a country can be used to map the use of public funds based on the geographical and socio-institutional distribution of poverty. This generally demonstrates a significant discrepancy between the intentions as described in public expenditure programming, for both capital and operating expenditures, and the actual destination of the funds allocated in this way. In many countries, this discrepancy should constitute a strong incentive to undertake a reallocation of these funds in order to better match intentions with achievements.

The combination of the Public Expenditure Review document and the Poverty Assessment provides an extraordinarily valuable basis for preparing national development plans, with entirely realistic prospects for determining how effective public expenditures are applied. A case in point is Burkina Faso, where a comparison exercise between the two documents was carried out at the initiative of the government in the mid-1990s. It brought together all the representatives of the country's society in an open and transparent manner. Predictably, it revealed a considerable gap between the needs highlighted by the Poverty Assessment and the application of public expenditures. In the end, it formed the basis for the formulation of a new and quite exceptional national development strategy. This type of exercise highlights the relevance of this approach in terms of effectiveness.

Such a reality check is not without significant risks when it comes to publicising these discrepancies, particularly from a political point of view. Indeed, holding this exercise and publishing these two realities, expenditures on the one hand

and needs on the other, involves obvious political and electoral risks. The government may not emerge unscathed from the comparison between the official discourse on the funding of public services and the reality as experienced in practice by marginalised populations in peripheral or neglected areas. In some cases, the government may simply refuse to release such documents in the run-up to an election, as was the case in Mexico at the end of the 1990s, for example.

In the private sector, however, we can rightly confirm some general lessons, namely the contribution of FDI to economic growth, increased productivity and poverty reduction. The contribution of SME development to job creation can be affirmed. Many other benefits confirm the potential effectiveness of private sector financing.

However, it would be extremely useful to take a comprehensive look at the whole issue, by comparing the specific features of the different types of contributions made by the main players in the private sector. This would give a better appreciation of the areas in which promotional actions, changes in strategies and policies, operating methods and regulatory mechanisms could be implemented.

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Conclusions and Recommandations

The brief overview presented above, which is probably incomplete and somewhat schematic, not to say caricatural, highlights the complexity of the subject of the effectiveness of one or more development finance systems from the point of view of the sources of finance, the beneficiaries and end-users, and the whole process in between.

We can only conclude that the assessment of this effectiveness is far from optimal in the current state of affairs. Commendable efforts are being made to address one or more of the themes mentioned above. But we are far from having a reliable overall assessment of the current situation.

Clearly, the discussions and proposals around the theme of effectiveness have been and continue to be largely guided by the concerns of donors, rather than those of users or beneficiaries. It seems necessary to identify and implement mechanisms that will enable users and beneficiaries to be much more closely involved in the whole process of improving effectiveness in development financing.

Even more worrying is the fact that we have few tools with which to propose alternative solutions. Identifying and analysing weaknesses and shortcomings in the current system is not enough to propose concrete measures with a good chance of improving things.

First recommendation. It would seem useful to take up the question of funding effectiveness as a whole, in order to better identify and analyse the realities of which this short document is only the beginning. This is undoubtedly an academic endeavour, based on precise references and concrete, practical operational experience. It should therefore be clarified how effectiveness can be identified and measured at all stages, namely first at the level of the stakeholders (backers, donors, various contributors, etc.), then at the level of the beneficiaries or users of the funding, and finally at the level of the instruments implemented between the two.

Second recommendation. The above observation clearly confirms that concerns about the effectiveness of development financing have focused primarily on the financing of development aid by international public sector organisations. However, it is clear that this is only part of the problem. It therefore seems necessary to continue and proactively extend attention to the effectiveness of other sources of funding, particularly from the private sector. This should also include the need for a much more thorough assessment of the role of all stakeholders and players who are not currently part of the formal and structured institutional ecosystem, both in the public and private sectors. New strategies should be identified to ensure over time a minimum of coherence between the two groups of players, the "traditional" and the "new". The case of China is particularly important, especially as regards procurement procedures, decisions on financing methods, debt treatment, etc. The focal point of such an effort should probably be within the United Nations system.

Third recommendation. It has to be said once again that concerns about the effectiveness of development funding, whether global or limited to development aid, seem to mobilise mainly the institutions of the contributing countries, the sources of the funding. It would be more than necessary to be able to rely on the views, analyses, suggestions and recommendations of the main players in the beneficiary countries concerned, in both the public and private sectors. Setting up structures, mechanisms and strategies for consultation with these representatives should be a priority. This will necessarily require a much more coherent, not to say joint, approach on the part of funders. A monitoring and oversight mechanism could be envisaged within the United Nations, or perhaps within the G-20 (i.e., within organisations that are less likely to be accused of "Western bias").

Fourth recommendation. Cross-referencing the review of public expenditure with the poverty situation in the countries concerned could serve as a basis for formulating strategies and programmes on the part of "donors", whether in the institutional public sector, the private sector, philanthropy, humanitarian aid or solidarity. A common basis serving as a reference for everyone, including the country's authorities and civil society, would avoid much of the dispersal of efforts seen to date, with objectives, strategies and interventions that are inconsistent with each other and sometimes contradictory, and certainly ineffective taken as a whole.

Fifth recommendation. The difficulties associated with the proliferation of external agencies, leading to States being bypassed by the creation of specific implementing agencies for external players, should lead to a substantial increase in efforts to help local authorities better manage the proliferation of players in this whole ecosystem. Efforts are still under way, but the results are still far below expectations. We can draw on the examples provided by the behaviour of countries that are already more advanced in this area.

Two Furrows of Aid Effectiveness “Bogged Down”*

Patrick Guillaumont, Sylviane Guillaumont Jeanneney

The expression ”aid effectiveness” is often a source of misunderstanding because its meaning differs fundamentally depending on whom you ask. If the person is an economist, he or she will immediately thinks of the hundreds of articles written to test econometrically the influence exerted by aid flows on economic growth or any other macro-variable important for development. This current of thought, which was very present and lively in the first decade of this century, has tended to fade away in the second in favour of numerous micro-evaluations of the impact of development projects with a view to identifying the most effective development aid initiatives.

If you are a civil servant in a developed country or a staff member of a development finance institution, you will think of the great debate initiated by the OECD with the Forum on Aid Effectiveness, which focused on aid modalities and targeted the behaviour of aid suppliers and recipients alike with a view to making aid more effective and promoting the accountability of partners. This forum, marked in particular by the Paris Declaration in 2005, was followed by meetings and declarations in Accra in 2008 and Busan in 2011 and then by other meetings that have received less attention.

Strangely enough, the two approaches to the question of aid effectiveness have remained rather separate but have not lost their topicality. They arise again and again, often sceptical and almost nostalgic. Is aid still effective? Under what conditions can it be? Is it even justified? When, as today, the issue is about mobilising more concessional resources for the development of poor and vulnerable countries and for the financing of global public goods, how can we make progress in these two areas?

* Guillaumont P., Guillaumont Jeanneney S. (2024) "Deux sillons ensablés de 'l’efficacité de l’aide'", FERDI *Policy Brief* B260.

Assessing Scientific Assessments

Let us look briefly at the evolution of the academic literature on the macroeconomic effectiveness of aid. The first decade of the century witnessed an explosion of articles devoted to the macroeconomic effects of aid on economic growth and poverty reduction. Most of these studies were cross-sectional, that is, they covered a sample of countries rather than being limited to a single country in a time series, for the simple reason that the response times for aid disbursements are extremely varied. In the early 2010s, it was possible to take stock of these cross-sectional studies, as we did, for example, by highlighting how they had revealed the specific effectiveness of aid in situations of vulnerability (Guillaumont and Wagner, 2013). Nevertheless, the scientific community has not reached a genuine consensus on the contribution of aid to economic growth and poverty reduction. The meta-analyses carried out in this area, while providing a good review of the literature, are not really suited to this purpose: they bring together too many studies that are heterogeneous in terms of their subject and the quality of their method to bring out a real consensus. Cross-sectional studies of aid effectiveness all encounter similar problems, which are unevenly addressed: the endogeneity of aid in the estimated relationship and the heterogeneity of situations of the countries in the sample considered, particularly from one sample to another.

By providing an apparently robust response to the problem of the endogeneity of aid and the heterogeneity of samples, microeconomic studies, popularised by randomised controlled trials (RCTs), have contributed to the move away from macroeconomic studies of aid effectiveness. However, the results obtained in a particular area cannot necessarily be transposed, let alone generalised. Of course, this does not mean that, within the limited framework in which these studies are carried out, they do not provide useful lessons for policy. They offer information on the effectiveness of aid (or other funding) in a certain context but by definition cannot report on the effectiveness of macroeconomic policies, given the difficulty of defining policy control groups.

Chauvet and Ferry (2023) stated that macroeconomic studies have made progress in dealing with heterogeneity. Indeed, macroeconomic studies, particularly those focusing on a single country, have sought to disaggregate observations at the territorial level, in particular by using geolocalised data. This is a promising avenue of exploration, even though not all social change can be captured through variations in night-time luminosity.

Will these new directions make it possible to overcome the methodological dilemma resulting from the respective limitations of cross-cutting macroeconomic analyses of aid effectiveness and microeconomic impact analyses, as both were so clearly identified by Angus Deaton back in 2012?

Coordinating Policy Coordinators

What kind of body is needed to ensure the transparency of a fragmented system of development financing and to assess its effectiveness? At the Busan conference on aid effectiveness in 2011, the oddity of the existence of two forms of high-level dialogue with similar objectives became apparent: the Aid Effectiveness Forum held in Busan, which had been preceded by the Paris and Accra meetings and declarations, implemented by the OECD, followed the Development Cooperation Forum (DCF) implemented at the United Nations by ECOSOC, the second (and last) meeting of which was held in 2010. The former could undoubtedly be considered more effective (the 2005 Paris Declaration on Aid Effectiveness seems to have had some impact) while being less legitimate than the DCF, which brought together all the countries of the United Nations (Guillaumont, 2011). This rather simple diagnosis now needs to be qualified.

The Development Cooperation Forum (DCF) continues to meet every two years (the last meeting took place in March 2023) and has gained little in terms of effectiveness or visibility: still under the aegis of ECOSOC, it has been supplemented, since the 2015 United Nations Conference on Financing for Development in Addis Ababa, by a Financing for Development Forum (FfD). The latter is generally held in New York in April, the week after the Bretton Woods Institutions' Spring Meetings, which take place in Washington. Its visibility seems to be increasing over time at the expense of that of the DCF.

The most important change has undoubtedly come from the evolution of the OECD's Forum on Aid Effectiveness, which has sought to involve all the countries of the world and therefore to be more legitimate. At the Busan conference, the Forum was transformed into the Global Partnership for Effective Development Cooperation (GPEDC), an association supported by the OECD and joined by the UNDP, a UN body that was supposed to provide greater legitimacy and that the developing countries, particularly the largest among them, were invited to join. However, what was already apparent in the Busan Declaration, namely the reluctance of major countries, such as China and India, to join the partnership, has subsequently proved to be a persistent weakness, despite more than 90 countries now having signed up. This weakness became apparent as early as 2014 at the Mexico conference, the first of the Global Partnership, although it was a good forum for discussions on concrete problems of cooperation for development. The subsequent conferences in Nairobi in 2016 and finally in Geneva in December 2022 certainly succeeded in bringing together a large number of political figures from a variety of backgrounds, but, it would seem, they were not highly visible, and the response of the press and the public to this "high-level" meeting of the GPEDC appeared limited.

The difference between the two discussion forums and their respective legitimacy is apparent from the communiqués that closed them[61]. On the one hand, the DCF communiqué clearly asserted its legitimacy to speak on behalf of all the countries in the world, whatever their level of development or economic importance. "The United Nations provides the global platform where challenges to and opportunities for international development cooperation should be discussed and dealt with in a collective manner, with all United Nations Member States at the table as equal partners joined by relevant stakeholders"[62]. On the other hand, the UN Forum clearly focused on the development concerns of the South. The main messages and general recommendations formulated by the Forum are summarised below, covering five areas: (a) address vulnerability in its multiple dimensions through more risk-informed development cooperation; (b) scale up development cooperation for climate resilience; (c) strengthen development cooperation to boost social protection to reduce risk and vulnerability; (d) enhance capacities to overcome the digital divide; and (e) shift the development cooperation paradigm to better respond to the trends and challenges in the sprint to achieve the 2030 Agenda for Sustainable Development".

Conversely, the Global Partnership Declaration makes much room for the concerns and values of the Western world, such as human rights and gender equality. For example, the fourth paragraph of the preamble read " No country has fully achieved gender equality – and significant levels of gender inequality persist globally. Progress on empowerment of women and girls is a prerequisite for inclusive development, democratic governance, social and economic justice, and peace[63]..."; furthermore, in paragraph 15, "We will be guided by the human rights-based approach, which requires that human rights principles (universality, indivisibility, equality and non-discrimination, participation, accountability) guide development cooperation".

Therefore, which body should be given the mandate to monitor and evaluate development cooperation policies and in particular financial flows: the reformed DAC, the Development Cooperation Forum (DCF), the Global Partnership (GPEDC), or a new body yet to be created?

61. On the one hand, "High-level political forum on sustainable development, convened under the auspices of the Economic and Social Council, 14 and 15 March 2023. Summary of the eighth high-level meeting of the Development Cooperation Forum Note by the Secretariat" and 'Global Partnership for an Effective Development Cooperation Summit 2022, Effective Development Co-operation Summit Declaration".

62. The statement continued: "The Development Cooperation Forum is a space where Member States have agreed to carry out the relevant mandates. Many participants called for the Forum's role to be not only sustained but enhanced. Developed and developing countries from all regions expressed their appreciation of the Forum as an invaluable (non-negotiating) space for inclusive discussions and shaping of norms and policies on high-quality and high-impact development cooperation".

63. The statement continued: "We can only address the multiple intersecting challenges facing the world and establish a meaningful social contract when we fully engage women and girls at all levels of society and in all decisions".

The Global Partnership has already declared its legitimacy to perform this function and plans to implement it by 2026, with a dashboard of all financial flows (cf. Annex 1 of the 2022 Summit Declaration[64]). It is true that it has the support of both the UNDP and the OECD; the latter has large competent teams at its disposal with its Development Cooperation Directorate, which feeds into the work of the Development Assistance Committee (DAC), and its Development Centre, which runs a programme independently and with the support of countries that are not members of the OECD, not forgetting the MOPAN (Multilateral Organisation Performance Assessment Network) responsible for monitoring the activities of multilateral institutions. The internal fragmentation of the analysis of cooperation policies within the OECD itself is perhaps not a good omen for inviting correction of the excessive fragmentation of the policies themselves. There is undoubtedly a lack of a real political mandate from OECD member countries but also from other countries in the South and the North that would like to join to make progress in monitoring and evaluating development cooperation policies and especially financial flows.

What then would be the chances of success of a reform with a mandate that would be given either to the OECD through the DAC extended to the Global Partnership (GPEDC) or to the United Nations through the Development Cooperation Forum (DCF)? Each of these two bodies already has its own history and governance, so which would be the most reformable on the basis of an international consensus? Furthermore, is a reform that would have them work together conceivable? Can the OECD be pushed to expand the GPEDC further towards the United Nations beyond the UNDP, which no longer fulfils its prior role of coordinating aid agencies at the country level, this role now having being devolved to the UN Resident Representative in a country?

It is also possible to allow the existing major international forums to evolve at their own pace, to formulate policy recommendations where necessary and, where appropriate, gradually to find ways of converging in a parsimonious way, that is, in a way that respects the time available to political leaders in developing countries.

64. "Implementation of the new Global Partnership Monitoring will address challenges of effective partnering in the evolving development co-operation landscape. The Global Partnership will provide timely and relevant evidence to inform dialogues, policies and practices, at both global and country levels. This requires political will and actions of all countries and Global Partnership stakeholders.
    - We will resume the monitoring exercise from 2023 and will complete data collection by 2026. This will also allow us to contribute to the Global Partnership's global reports with country level data and provide evidence on progress for the forthcoming Senior- and High-Level Meetings...
    - We will promote accountability and transparency through a dashboard that will be updated regularly (as countries complete the monitoring phases and provide information) to track countries' progress, including on key metrics and action plans. We will also provide monitoring results profiles for partner countries and development partners, to inform parliaments and other stakeholders for awareness raising and dialogue."

If it is politically impossible to reform by merging, perhaps the simplest solution would be to create a new body based on the existing ones, with the obvious risk of adding further confusion to a system that is already suffering from it. A mandate would therefore be given to an ad hoc institution (public or private?) to monitor, on a comparative basis, the policies implemented by public development funding bodies and philanthropic institutions on the basis of criteria to ensure that the policies of each of these bodies are consistent with the purposes of the funding and their overall coherence (as proposed in Severino and Guillaumont Jeanneney, 2023)"). This institution, which should report annually, would be similar to the DAC Secretariat but with a broader geographical or geopolitical base, including other countries (developing countries at different income levels) in addition to OECD countries, as the GPEDC has tried to achieve with limited success, and with a slightly different and more targeted objective, that of ensuring the transparency of the system to increase its effectiveness. It should naturally work in cooperation with the DAC secretariat but also with the GPEDC, MOPAN and, of course, the DCF and FfD, or even UNCTAD, as the latter would be mandated! It could also, insofar as the OECD agrees, involve the broadening and deepening of the DAC secretariat, which would mean a profound reform of the DAC itself. If no agreement is reached between public institutions, it may be up to a small group of private institutions from the North and South to offer their services to achieve this and possibly receive a mandate to do so.

Whatever the institutional formula chosen, it is important that the evaluations of aid effectiveness carried out on the institutional and procedural side are in line with those performed on the analytical side. The best institutional arrangement once again runs the risk of becoming bogged down if it is not irrigated by the results of research into the effectiveness of the various types of external financing for development and global public goods. The two strands of aid effectiveness that we have identified must come together if they are not to get bogged down.

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A Global Financing Pact for Poor and Vulnerable Countries?

21 Contributions from the Chair in International Architecture of Development Finance to the Summit for a New Global Financing Pact, June 2023

The financial difficulties faced by many poor and vulnerable countries in ensuring their sustainable development have been exacerbated by the major crises the world has encountered over the past four years. These crises have highlighted the need for a profound reform of the international development finance architecture. To contribute to this objective, Ferdi established in 2022 an eponymous chair led by a group of independent and highly experienced French-speaking personalities. The reflections of this group, notably in preparation for the Summit for a New Global Financing Pact in Paris in June 2023, have resulted in the organization of eight conferences on the key issues of development finance and the publication of more than twenty working papers and briefs, from which FERDI has proposed ten recommendations for the reform of this architecture.

This book compiles the short versions of these contributions. It is structured around three main themes: the organization of the new financing pact, the mobilization of new resources, and the allocation of these resources. This work represents the first step in a series of publications that the FERDI's International Development Finance Architecture Chair intends to release by the 4th United Nations Summit on International Development Finance scheduled for 2025.

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