WHAT'S IN THE COMMITMENT? *UNLOCKING 0.7%*

Policy Paper

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Introduction

2015 is a critical year for sustainable development, some are even calling it a "once in a generation opportunity" (UNDP 2015) to address the world's social, economic and environmental challenges. 2015 sees a range of critical global summits take place to address these challenges, including the Addis Ababa Third Financing for Development (FfD) Conference in July, the UN General Assembly meeting to agree the Sustainable Development Goals (SDGs) in September and the Paris UN Climate Conference in November/December. *As illustrated by this paper, clear and strong political ambitions from EU member states on aid and commitments to pursue a genuinely development-driven catalytic approach to using this vital resource will be critical to a successful outcome to the Addis Ababa FfD Summit and possibly those that follow.*

The Addis Ababa FfD Conference holds special significance, for two main reasons. Firstly, it will aim to guide efforts to mobilise the required resources and prioritise other related policy issues to achieve the SDGs. The additional financing needs here are enormous, with the UN stating they are *"estimated to be of the order of several trillion dollars per year* "(UN-ICESDF 2014, p10).

Secondly, as it is the first of these major summits its outcome may set the tone for the UN SDG and climate summits. If the outcome is an ambitious one, this can help to raise ambitions at the UN SDG and Climate Summits. Of course, the danger is that the opposite could also happen, leading to ambitions for New York and Paris spiralling downwards, possibly towards failure.

Given the EU's global standing and its significant and diverse capabilities for supporting sustainable development the agenda that EU Member State's (EU MSs) bring to Addis Ababa is likely to determine which of these scenarios emerge. An ambitious EU agenda for Addis Ababa is therefore urgently required and a necessary precondition for a successful outcome of FFD3.

Amongst the critical areas which must be addressed in such an EU agenda for Addis Ababa are those relating to ambitious next steps on aid quantity and quality. Although EU commitments in these areas alone will not be adequate, they are an important barometer of its commitment to development and a signal of the EU's credibility as a negotiating partner. As highlighted in section 1 of this report, slow progress in achieving their aid commitments has eroded trust in the EU as a development actor. It is therefore vital that Addis Ababa is used as an opportunity for the EU to change this narrative and renew its political emphasis on aid.

In pursuing an ambitious agenda on aid EU MSs must ignore views that EU aid is losing its significance in supporting sustainable development. This false rhetoric has been promoted by those looking to undermine political commitment to aid and is a misreading of the changing context for developing countries, as illustrated in section 2 of this Report.

In terms of aid quality priorities, EU MSs are right to call for efforts to deepen the catalytic impact of aid. However, as presented in section 3 of this paper, the current EU/donor approach to such a concept needs refocussing so that bold steps can be taken to ensure that EU aid truly catalyses sustainable development outcomes.

This paper concludes in section 4 by presenting specific recommendations of CONCORD AidWatch members for how the EU can play its fair share to ensure the Addis Ababa agenda on aid becomes a success.

1. Trends in EU aid 2000-14

Developed countries first committed to provide 0.7% of their national income as aid in 1970, a commitment which was reaffirmed in the 2002 Monterrey Consensus on Financing for Development (FfD) as a key component of efforts to achieve the Millennium Development Goals (MDGs). EU aid promises were taken further in 2005, with commitments by EU-15 MSs to provide 0.56% of GNI as aid by 2010 and to reach the

0.7% of GNI target by 2015. This same year also saw the EU-12[1] commit to provide 0.17% of GNI as aid by 2010 and 0.33% of GNI by 2015. Over the last decade EU MSs have also made extensive commitments related to aid and development cooperation effectiveness, including by endorsing the Paris (2005), Accra (2008), Busan (2011) and Mexico agreements (2014), as well as through their own internal aid reform processes.

The analysis which follows reviews the performance of EU MSs in meeting these aid quantity and quality commitments. It illustrates that they have made some very significant progress and some EU MSs have met their aid quantity commitments. However, in the case of most MSs and generally with regard to aid quality their performance has fallen some way short of their commitments. As a result EU MSs have failed to ensure that EU aid maximises its contribution to sustainable development.

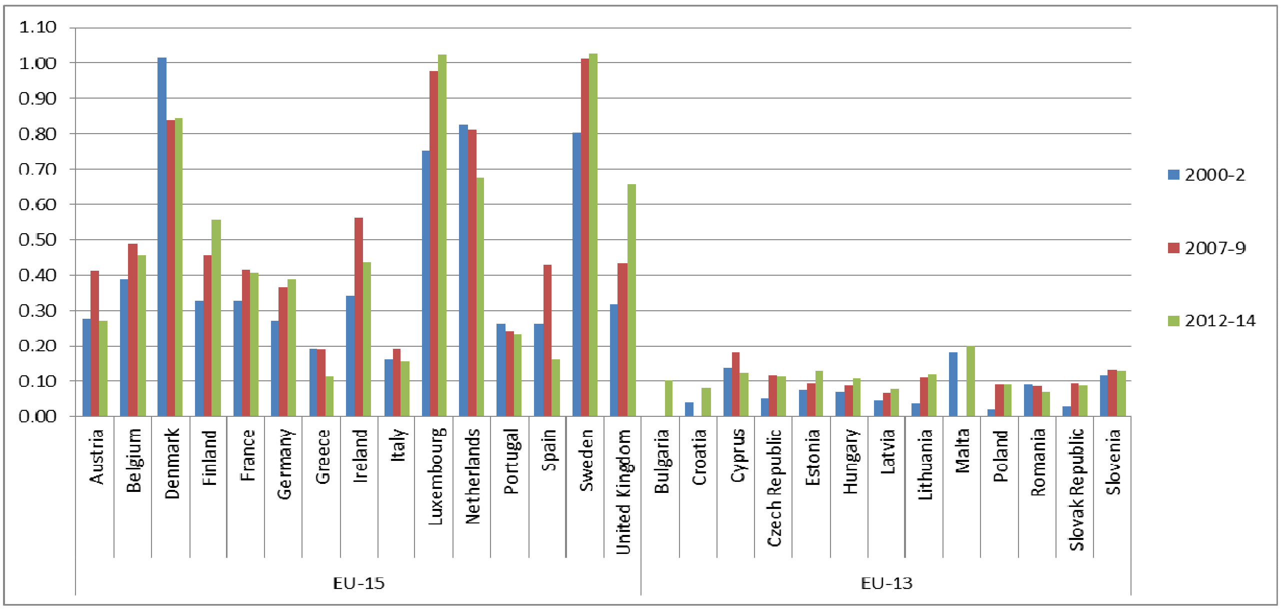
1.1 Aid quantity

Three EU MSs have had aid levels of at least 0.7% throughout the period 2000-14 - Sweden, Denmark (who have both met this target since the 1970s) and Luxembourg. In addition, aid from the Netherlands was above 0.7% of GNI before 2012 (and since 1975) and the UK reached this level in 2013. The Netherlands and Finland (since 2014) have met the 2010 target of 0.56% of GNI, and the Netherlands has recently committed to increase its aid levels back to above 0.7%.

Amongst the other nine EU-15 MSs, despite most of them achieving notable increases in their aid/GNI levels at some point since 2000, significant recent aid cuts have left them with aid/GNI levels below (in the case of Greece, Spain, Portugal and Austria) or barely above (Italy, Belgium, France, Ireland and Germany) their 2000-2 average during 2012-14. Five (Italy, Spain, Greece, Portugal and Austria) of these EU MSs have not yet even met the EU-13 commitment of 0.33% of GNI.

In terms of the EU-13, none have at any time in the period since 2014 reached an aid level of 0.33% of GNI. Three (Estonia, Malta and Slovenia) of this group of MSs have though met the 2010 target of 0.17% of GNI, with an additional two (Cyprus and Lithuania) having met the 0.17% of GNI target at some point during the last decade but subsequently reduced their aid below this level. It is though notable that with the exception of Romania all EU-13 MSs have increased their aid levels since they began official reporting on them, although for most this was from a very low base.

Aid to GNI levels for EU member states, 2000-2, 2007-9 and 2012-14



Source: OECD DAC CRS table 1

[1] There are now 13 new EU MSs as Croatia joined the EU in 2013

If EUMSs had met their aid commitments in 2014 then their aid levels would have been €43bn (or 41%) higher. Amongst EU MSs, those who made the largest contribution to this aid shortfall were Germany (20% of the total shortfall), Italy (20%), France (17%) and Spain (13%).

Furthermore, it is also important to note that these official ODA figures include significant elements of aid which don't result in resources flowing to developing countries, and which CONCORD AidWatch refer to as "inflated aid" – hence "genuine aid" is even lower than the reported ODA levels. CONCORD AidWatch has been monitoring the volumes of inflated aid since 2006. Although overall levels of inflated aid have fallen in recent years (largely due to lower levels of debt relief) such aid was still equivalent to around 10% of total EU aid in 2013 (CONCORD AidWatch 2014).

Levels of inflated aid vary significantly across EU MSs. As reported in the 2014 CONCORD AidWatch Report bilateral aid was almost fully genuine for three EU MSs in 2013: Luxembourg (99.8% genuine aid), Ireland (99.7%) and the UK (99.7%). At the other end of the spectrum, bilateral aid from Greece was completely composed of inflated aid, thanks to student and refugee costs. In addition, over one-third of all bilateral aid provided by France (due to student and refugee costs and debt relief) and Spain (due to debt relief) was inflated (CONCORD AidWatch 2014).

In terms of aid disbursements to Least Developed Countries (LDCs), during 2004-10 these volumes rose as a share of GNI (without reaching the OECD DAC target of 0.15%-0.2% of GNI), but then fell during 2010-12 to reach 0.11% in 2012 before recovering somewhat in 2013. Again, performance varies across EU MSs, with Denmark, Finland, Ireland, Luxembourg, Sweden and the UK achieving the 0.15% of GNI target in 2012, but fourteen MSs reporting they do not expect to reach the this target any time soon (EC 2014).

1.2 Aid quality

Aid tying – EU MSs have committed to untie aid to all Highly Indebted Poor Countries/HIPCs (Accra) and to accelerate the untying of their aid to all countries (Busan). Two EU-15 MSs (Ireland and UK) kept their aid fully united during most of the period 2000-13. Of the other thirteen EU-15 MSs, comparing the periods 2000-2 and 2011-13, eleven increased their untied aid ratios, one (Italy) by more than 30 percentage points and three (Spain, France and Greece) by 20-30 percentage points. Two EU MSs reduced their untied aid ratios during this period - Portugal (by 51 percentage points) and Austria (by 12 percentage points). Eight MSs still tied more 10% of their aid in 2013: two (Spain and Croatia) tied 10%-25%, three (Czech Republic, Estonia and Slovakia) tied 25%-50% and three (Portugal, Slovenia and Hungary) tied more than 50%. Overall 20% of EU bilateral aid remained tied in 2013 (EC 2014).

In addition, analysis suggests that informal tying of aid remains a problem, as a number of EU MSs who nominally have untied their aid award a very high proportion of their aid contracts to companies from their own countries. The most notable cases, based on data for contract awards on aid to LDCs and HIPCs in 2010, include Finland (92% in value terms awarded to national companies) and Denmark (84%), as well as the UK (89%) (OECD 2011b), which has sharply increased contract awards to national companies in recent years (see box below).

The politics of donors procuring through national companies – the case of the UK

DFID formally untied its aid in 2001, although historically a significant proportion of UK aid contracts have been awarded to national companies. In the late 2000s efforts were made to address the practical barriers facing none British companies in competing for aid contracts (DFID 2011), and as a result the share of centrally awarded UK aid contracts awarded to British companies fell from 80% before 2007 (DFID 2007) to 68% in 2008/9 (DFID 2009). However, following a change of Government in 2010, this figure rose sharply to reach 92% during 2010/11 (Guardian 2012) and has since remained above 90% (DFID 2014). This trend has coincided with increased emphasis by the UK Government on the role of British companies in supporting its development efforts.

Use of country systems – In 2005 EU MSs made a modest commitment to collectively deliver at least 50% of their aid through country systems, a target they met in 2012 (EC 2014). However, performance has varied across EU MSs, with Ireland channelling over 80% of its aid through country systems, and France, Denmark and Finland delivering 70% of their aid in this way. In terms of trends over 2005-12, four EU MSs (Italy, Denmark, France and Finland) have increased the proportion of their aid through country systems by more than ten percentage points (EC 2014a); Netherlands, Portugal, UK and Sweden have significantly reduced their aid through country systems in recent years (GPEDC 2014). In addition, EU MSs have been reducing their budget support significantly in recent years and only three (Belgium, France and Ireland) currently use any form of budget support for more than 10% of their bilateral aid programmes (EC 2014b). The EC however remains one of the main providers of budget support globally.

Transparency – EU MSs have been amongst the most active supporters of efforts to improve the transparency of aid. This has included helping to launch and promote the International Aid Transparency Initiative (IATI) and endorsing the Busan commitment to "Implement a common, open standard for electronic publication of timely, comprehensive and forward-looking information on resources provided through development co-operation" by 2015. To date only nine EU MSs and the EC have met this commitment, and nine of the EU-13 are yet to publish schedules to guide their implementation. In addition, the level of ambition of the reporting of (and plans to report) aid information vary significantly across EU MSs (CONCORD AidWatch 2014).

Joint programming – The EU has expanded joint programming from six pilot countries to fourty countries, and plans to extend it to a further twelve in the coming years. However, developing countries where joint programming has been implemented have raised concerns about coordination undermining alignment, as well as in relation to donor-driven sector allocations and limits to consultations with national stakeholders (CONCORD AidWatch 2014).

1.3 Addressing the EU's declining reputation as an aid and development actor

The failure of EU MSs to meet their aid quality and quantity commitments over the last decade has eroded trust in the EU as an aid and development actor. This is perhaps most apparent with regard to EU aid quantity, which was only increasing slowly before the global financial crisis, and has since fallen in real terms at the EU level and across many MSs. This represents a colossal failure of political will from EU MSs, as illustrated by the positive case of the UK which despite introducing spending cuts domestically since 2010 has also increased its aid significantly in order to fulfil its commitment to reach 0.7% in 2013.

Although the impacts of the global financial crisis do not in any way provide an excuse for EU aid cuts – after all EU aid targets are based on a share of national income – most MSs are expecting to see growth return to close to pre-crisis levels in the coming years (EcoFin 2015). This provides a supportive environment for renewing their political commitment to aid increases and taking the steps necessary to deliver these increases.

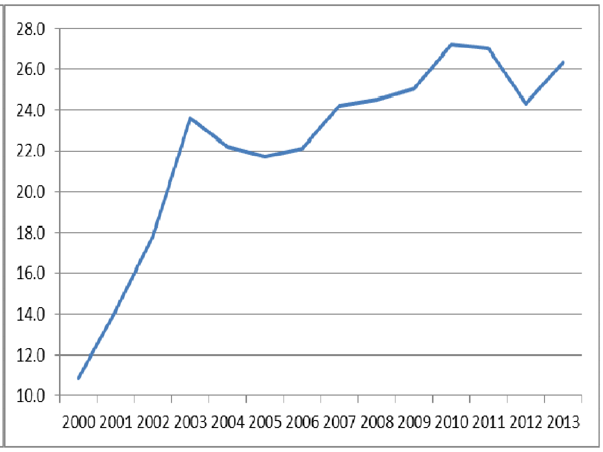
Given this context and the delivery deficits of the last decade the failure of EU MSs to agree to ambitious aid commitments in Addis Ababa could cause irreparable damage to the EU's reputation on aid and development, and undermine the prospects for a successful outcome from this critical Conference.

2. Responding to myths about aid

Since the MDGs were adopted in 2000 the international context for aid has changed significantly. Developing countries have mobilised increased levels of domestic resources to invest alongside aid and been growing rapidly. These trends have emerged at the same time as global aid levels have been increasing, suggesting that aid has not weakened growth or revenue prospects as some commentators would suggest is the case in critiquing aid.

Net ODA to LICss, 2005 $ billions

Revenue and growth in LICs, % of GDP



Sources: World Development indicators; *Note:* No data on revenues for 2000-1, 2004-5 and 2012-13

Another important development has been the increasing diversification of the aid community, with the rise of new emerging economies providers of development cooperation and the increased prominence of foundations and new forms of philanthropic investment helping to widen the sources of assistance available to developing countries (Greenhill et al 2013).

These developments are undoubtedly significant and it is important that aid allocation and other policies adjust to them. However, these changes have been used by many OECD Governments and commentators to promote an unconstructive, self-serving and false narrative which threatens to undermine the case for aid. The sections that follow challenge the key strands of this narrative and illustrates that aid is, and will continue to be, one of the most critical resources for pursuing the SDGs.

2.1 MYTH 1 – The development job is mostly done so aid is less important

The development achievements of the MDG era have been significant. These include meeting the first MDG of halving global poverty rates and an almost halving of child mortality globally (UN 2014). Growth levels across developing countries have also improved from an annual average of 3.9% in the 1990s to 5.8% in the years since (World Bank 2015) and the number of low income countries has fallen from 63 in 2000 to just 34 today.

These achievements and trends are to be celebrated and a cause for optimism for the future. However, they must not allow an attitude that the development job is mostly done to emerge, undermining the case for aid and the resolve of the international community during 2015.

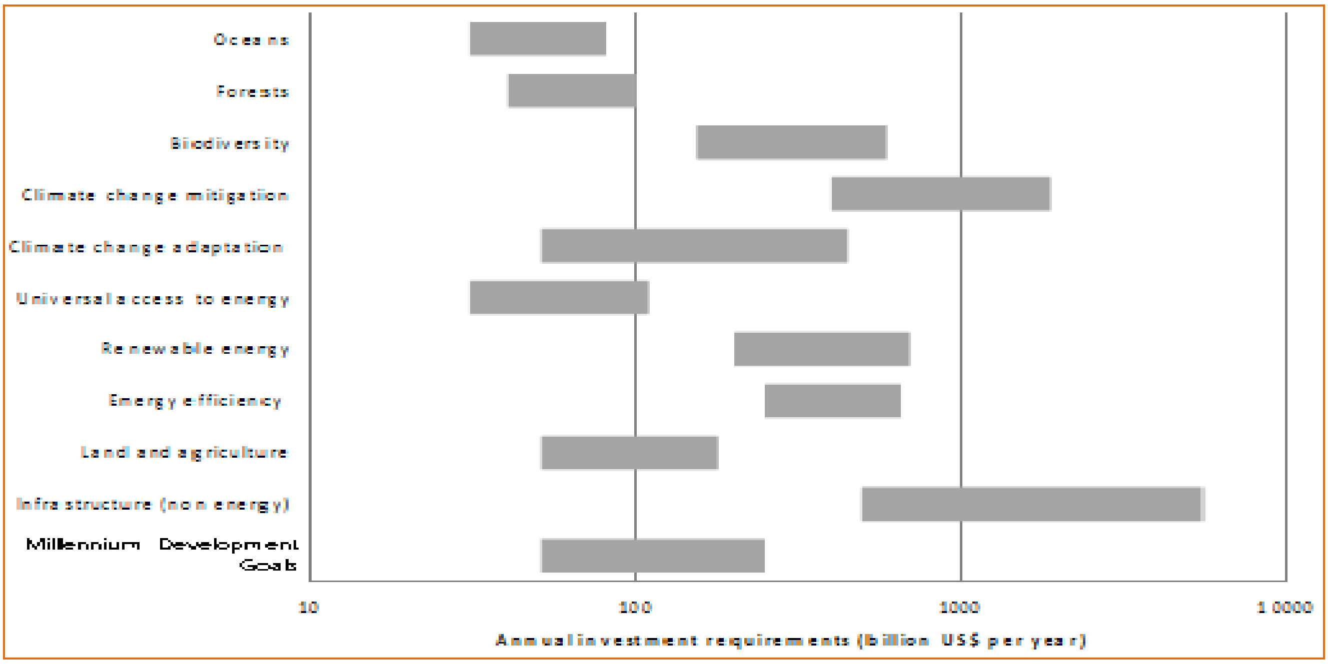
A long, hard, honest look at the data should leave no one in any doubt that the challenges which remain to be addressed in the post-2015 era are enormous. Most projections suggest that a business as usual scenario will still leave hundreds of millions of people below the measly $1.25 extreme poverty line in 2030. The halving of global poverty rates has been largely down to the growth of China, with extreme poverty levels having only marginally fallen (from 56% in 1990 to 48% in 2010) in regions such as sub-Saharan Africa (SSA) (UN 2014). Despite achievements in relation to access to education and health, based on current trajectories low income countries will not achieve universal completion in primary education until at least the 2060s (Lange 2014) and an intolerable one in ten children still die before their fifth birthday in SSA (UN 2014). In addition, below the surface of the trend of growing numbers of Middle Income Countries (MICs) are significant challenges related to inequality and many millions remaining in poverty in these countries (Glennie 2013).

It is also important to note that as global poverty becomes increasingly concentrated in SSA, where the depth of poverty is most extreme[2], a smaller number of people are expected to be living just below the $1.25 poverty line in the coming years (Chandy et al 2013). This means reducing extreme poverty will be a much harder task after 2015 than it was in 2000.

[2] The average daily income of the extreme poor in SSA has been mostly flat since 1981, and currently stands at $0.71 in purchasing power parity terms, barely above half the global extreme poverty line of $1.25 (DI 2013)

Finally, the effort by the SDG framework to combine a focus on development with bringing greater attention to environmental and climate change issues - which if not addressed could end up reversing recent development progress - implies a scaling-up of efforts is required. This is reflected in the fact that the resourcing implications of the SDGs are huge (see graph below).

Orders of magnitude of investment requirements for various sectors taken from the literature



Source: UN-ICESDF (2015)

This analysis all adds up to a very challenging sustainable development agenda to be addressed in the post-2015 era, with very significant resourcing implications. Describing this context as one which makes aid less important is to ignore the facts and the global emergency being addressed by the SDGs.

2.2 MYTH 2 – Increased domestic resource mobilisation means that developing countries no longer need as much aid

Developing countries have made very significant progress in mobilising domestic resources over the last decade or so. Across all developing countries public revenues are estimated to have increased by an annual rate of 14% during 2000-12, reaching an estimated $7.7 trillion in 2012 (World Bank 2013). These dramatic increases are helping to generate unprecedented optimism about the ability of developing countries to finance their own development in the future.

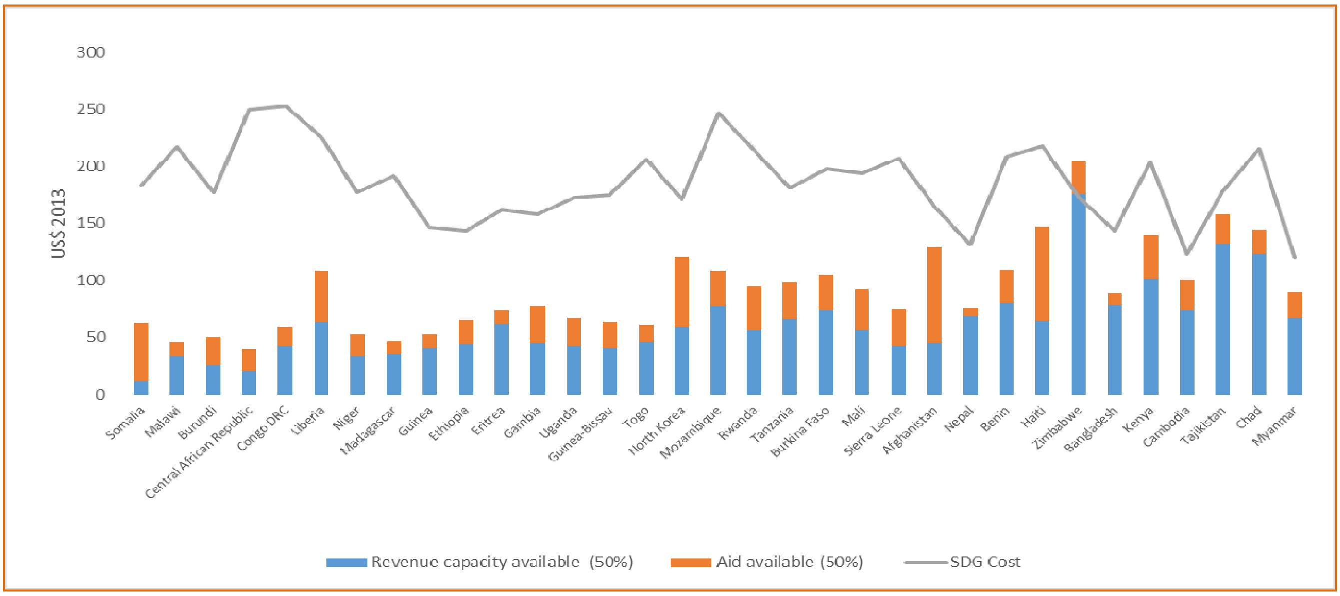
It is though important to note that that this story is predominantly a MIC one, with Low Income Countries (LICs) having mobilised just 2% of these revenues in 2012 (World Bank 2015). These mean that although LICs doubled their domestic revenues in real terms over the last decade leading to them outstripping net Official Development Assistance (ODA) levels,[3] ODA still represents a very important additional contribution to the resources available to the poorest countries.

This picture is reinforced when it is understood how trends in domestic revenue mobilisation translate into Government spending per person in these countries. An estimated 377 million (more than a quarter of the world's extreme poor) live in countries where annual public spending is less than $500 per capita (DI 2014).[4]

[3] In 2011 LICs mobilised an estimated $68 billion of domestic revenues in 2011, which compared with net ODA of $42 billion in the same year (World Bank 2015).
[4] Around half of the world's extreme poor live in countries where annual public spending per capita is $500-$999

These levels of resource mobilisation are estimated to currently leave developing countries facing an $84 billion per year financing gap to provide access to a basic package of education, health and social protection services (ODI 2015) – see graph below - and a financing gap of at least $400 billion to meet all of the MDGs (DFI-Oxfam 2015). To put these figures further into perspective, the French Government spent more than $24,000 per capita in 2013, equivalent to $500 every week.[5]

Public finance (revenue + aid) available and cost for basic package of education, health and social protection across Low Income Countries



Source: ODI (2015); *Note*: Assumes LICs reach their revenue capacity, and allocate 50% of public revenue and is to these three areas of service delivery

Of course, this is the current picture, and if recent positive trends continue the poorest countries will be able to fill some of these and other important financing gaps with their own resources. It is though important to note that the poorest countries can only increase revenue levels at a relatively modest pace (Drummond et al 2012), meaning that they will continue to face resourcing challenges for many years to come. This is especially the case given the very significant gaps which have been identified for addressing all of the SDG priorities (see introduction).

This analysis therefore suggests that the very impressive revenue mobilisation outcomes achieved by developing countries over the last decade or so do not undermine the case for increasing aid levels, especially for the very poorest countries. In fact, these achievements suggest that developing country institutions are maturing and could therefore manage such aid increases much more effectively than before.

2.3 MYTH 3 – The private sector can take the lead in filling sustainable development financing gaps

In the debate about how to finance sustainable development efforts after 2015 one of the most dominant themes that has been promoted is the importance of using public resources (including aid) to encourage private investment in helping to meet the SDGs. This agenda (addressed further in section 3) illustrates a growing view amongst OECD Governments and commentators that the private sector can take the lead in filling sustainable development financing gaps.

Such an agenda is problematic for a number of reasons. Firstly, it threatens to undermine the case for aid (and public domestic resources) by promoting the belief that private finance can and should substitute for these resources in supporting the SDGs. Such a perspective fails to recognise the fundamental differences between

[5] Authors own calculation using data from OECD.stat

these sources of finance, especially with regard to their ability to support poverty reduction and pursuit of the SDGs, as highlighted in the box below:

The unique characteristics of aid vis a vis private finance

- **Effective aid can target public services and support private enterprise for poor people** – as the objective of aid is development and poverty reduction it can support the most vital investments required to pursue these goals; private investment will only reach those who can afford to pay for such services
- **Effective aid is available now, and helps establish longer term resource collection** – aid can provide a rapid, front-loaded development resource, supporting countries whilst they develop other sources of financing, ensuring vital development investments are not delayed; private finance avoids the poorest countries, is often volatile and can take time to develop
- **Effective aid can help support accountable institutions and improve governance** – when donors work through national institutions thy can help to promote transparency and accountability across public and other forms of financing; private finance does not link to these institutions
- **Effective aid does not undermine public finances** – aid represents the most affordable form of international financing and it therefore poses limited burdens on a countries' finances; private financing implies a demand on future financing streams and needs to be carefully managed to avoid debt distress

Perhaps the most important of the characteristics highlighted above is that aid can be targeted on the poorest and most marginalised, whereas the private sector reaches only those who can be profitably be served by paying for services. This point is well illustrated by the painful experiences of developing countries with introducing user fees – a feature of private service provision - in education and health in recent decades, which led to the poor being excluded (Lagarde and Palmer 2008; Rabinowitz and Prizzon 2015).

This perspective also ignores evidence that it is public resources which are critical to progress in sectors where private financing is being promoted, especially in the early stages of development when risks for investors are high. For example over 80% of investments in developing countries over the last decade have been made by the public sector (WB/G20 2014). It is also the case that the public sector often has to take on the risks from private investment, as illustrated by experiences following the global financial crisis when the public sector had to bail-out reckless private institutions.

This analysis therefore suggests that it is absolutely not the case that private financing can take the lead in addressing SDGs resourcing needs, and therefore aid (and other public sources) have a fundamentally distinct and critical role to play in supporting pursuit of the SDGs.

2.4 MYTH 4 – The rise of emerging economy donors and other new providers are making OECD aid increasingly less important

As already highlighted, one of the features of the recent aid context is that there are increasing volumes of development assistance from providers beyond the OECD Governments. Not only have traditional emerging economy providers (e.g. Brazil and China) been scaling-up their assistance, but additional emerging economy providers have initiated development cooperation programmes (e.g. Indonesia and South Africa) and support from foundations and philanthropic investors has been growing. Given these trends it seems tempting to some to suggest this spells the decline of the significance of OECD aid. However, the statistics don't support such a narrative, and to a large degree OECD Governments themselves will determine the degree to which it emerges.

The most recent and perhaps authoritative estimate of current levels of SSC (focussing on those forms of SSC most closely approximating the concept of ODA) is a UN figure of $16.1-$19 billion for 2011 (UNSG 2014). SSC was therefore equivalent to no more than one-eighth of gross ODA from OECD Development Assistance Committee (DAC) member Governments in 2011.

The main reason that SSC has even grown to this size relative to OECD ODA is that OECD ODA has stagnated in recent years whilst SSC has been rapidly increased. This point highlights that it is actually to a large degree up to OECD DAC and EU Governments how significant their ODA remains in volume terms relative to SSC provides.

Commentators have also rightly pointed to the growing significance of foundations (e.g. the Bill and Melinda

Gates Foundation) and philanthropic investors (e.g. impact investors and peer to peer lending platforms) in channelling assistance to developing countries. Again here it is important not to overstate the significance of these providers in volume terms, as research has suggested that their impact is yet to be significantly felt at the country level (Greenhill et al 2013).

Of course the significance of different providers of development cooperation depends on the quality of their assistance and not just its volumes. In this regard the message again is that it is up to EU MSs to determine the quality of their aid ODA vis a vis other actors, and there is certainly much more EU MSs can do in this areas in order to assert their significance.

It is therefore clear that the rise of the new development cooperation providers has not yet led to OECD DAC providers losing significance, and that they can retain their significance through ambitious action on aid quantity and quality.

It is vital these myths are put aside in 2015

This analysis has therefore emphatically shown how these myths about the current and future context for aid represent a misreading of the evolving development agenda at best, but a false and self-interested analysis at worst. Sustainable development challenges remain significant and are arguably becoming more complex; despite dramatic achievements in domestic resourcing mobilisation many developing countries remain some way short of the financing they need for meeting the SDGs; private finance is not capable of taking the lead in meeting the SDGs, especially as they relate to the poorest and most marginalised; and EU and other OECD actors will remain the most significant aid providers for some time to come.

It is therefore important that these myths are put aside as we move towards the Addis Ababa FfD Conference, and the SDG and climate Summits that follow. They only serve to undermine efforts to ensure that 2015 delivers an ambitious agenda for action on sustainable development.

3. An agenda for making EU aid truly "catalytic"

In recent years the impact of the global financial crisis on public spending in donor countries and the fast approaching MDG deadline have provided an important backdrop to the aid agenda. These contextual factors have both contributed to an increased emphasis on how the impact of aid can be deepened, which donors have been keen to refer to as promoting "catalytic" aid.

As already mentioned in section 2, policy statements produced by the EC and EU member states in recent years suggest that the primary focus of their pursuit of "catalytic" aid has been to increasingly utilise this source of financing to stimulate (or "leverage", to use the term donors have adopted) private investment in developing countries. In supporting this agenda EU member states have been encouraging an increased focus on aid supporting private companies through blending grants with loans, developing private sector risk-sharing mechanisms backed by aid and promoting aid financed public-private partnerships (PPPs).

Despite its apparent appeal given the vast resources available to the private sector, such an approach to catalytic aid is deeply problematic for a number of reasons. Firstly, it ignores major questions about its development impact and neglect of development effectiveness principles. Secondly, it fails to give sufficient prominence to the most important development resource that aid can support - domestic revenues. Finally, it also neglects a range of aid practices which undermine the catalytic potential of EU aid, especially tied aid and use of country systems.

Sections 3.1-4, which follow, address in turn each of these points identified above. They illustrate why these policy areas should be central to promoting the catalytic potential of aid, drawing on evidence from the research literature and analysis of the performance of EU MSs.

3.1 Taking a more critical view of public-private aid partnerships and ensuring they fully address development effectiveness principles

In very actively promoting the use of aid to provide direct support to private companies to leverage their resources EU MSs are ignoring a range of serious questions about this approach.

Firstly, there is the issue highlighted in section 2.3 that working through the private sector implies an effort to target those who can be profitably served by these actors, which all too often excludes the very poorest and most marginalised.

Secondly, there is the lack of evidence that these approaches to aid have actually supported resource mobilisation and development outcomes. A number of studies have suggested that public-private financing instruments have commonly failed to generate additional resources for developing countries, and instead simply substituted for (and therefore subsidised) investments that would have occurred without aid (CP 2014; European Parliament 2014; Spratt and Collins, 2012; IEG 2009). There is also limited evidence regarding the development outcomes emerging from the use of such financing instruments (Kwakkenbos 2012; Spratt and Collins 2012; IEG 2011), with Development Finance Institutions having been criticised for failing to "actively seek to influence project design or policy to improve direct poverty outcomes" (Spratt and Collins 2012, p96).

Thirdly, as already noted in section 2.3, this agenda ignores the risks that these financing approaches pose to the fragile public finances of developing countries. These risks have been illustrated by the recent experiences of African countries in engaging with international bond markets (Tyson 2015) and in Lesotho's experience with a PPP in its health sector (Marriott 2014). The capacity constraints developing countries face in their public administrations are also relevant, as managing these public-private instruments effectively requires significant expertise, which many countries do not have and / or could arguably better use in other areas of the public sector.

Finally there are questions relating to the degree to which these public-private financing instruments address a range of other development effectiveness principles. Their transparency is weak, it is challenging for citizens to hold actors involved accountable and there is a limited focus on ensuring the resulting investments are compliant with sustainable development principles.

As a result of these continued questions about aid supporting private companies, CONCORD AidWatch members call on EU MSs and other aid providers to take a more selective approach to using aid for such purposes. This should involve testing proposed projects/investments against a range of effectiveness principles, which should be met as a condition of approving aid funding and continued disbursements. These principles should include the following:

- *Build on development effectiveness principles*, including responding to nationally-driven agendas and addressing relevant aid effectiveness issues
- *Demonstrate additionality and value for money*, by pursuing more robust standards for assessing and pursuing financial and development additionality
- *Share risks and minimise debt,* by avoiding arrangements that threaten to undermine the public finances of developing countries and adequately addressing the risks involved
- *Ensure transparency, accountability and participation* at all stages of project/investment delivery, including design, tendering, implementation and evaluation stages
- *Ensure good corporate governance* by only engaging with companies which adhere to human rights and sustainable development principles and standards
- *Maximise benefits of the project, as well as ensure interventions do no harm by applying sustainable development principles of* poverty alleviation and social development, equitable environmental sustainability and inclusive and sustainable economic development

EU MSs should therefore commit to applying these principles as central element of their agenda on catalytic aid and their aid policy package for Addis Ababa.

3.2 Prioritising catalysing domestic revenue mobilisation levels by using aid to address relevant domestic and international constraints

Tax and other public revenues provide the most important source of financing available to developing countries for investing in sustainable development. These are also the resources which developing countries have the most ownership over and which are most open to public scrutiny. It is therefore vital that in using aid to catalyse other sources of financing that EU MSs prioritise a focus on domestic resource mobilisation (DRM) rather than on private financing. Donors currently utilise only a very small proportion of their aid (as little as 0.07% according to one estimate - DI 2014) for supporting DRM and it is therefore vital that EU MSs use aid more effectively in this area, including by supporting civil society to hold Governments accountable for their use of public resources.

It is also important that the full range of impediments to DRM in developing countries are addressed through such support. EU policy statements supporting such a focus for aid commonly strongly emphasise the importance of EU aid helping to address the domestic aspects of DRM challenges, e.g. the weak capacity of domestic tax administrations. However, they fail to adequately address how aid can help to respond to the enormous challenge of illicit financial flows from developing countries – estimated to be almost $1 trillion in 2012 (GFI 2014) - which are facilitated by an unfair international tax and financial system. Aid can help developing countries to build the capacity to effectively engage with multinational companies with whom they negotiate tax regimes, as well support them to effectively play a role in international forums addressing these issues. Donors should also commit to end the practices of the Development Finance Institutions they support in routing their investments through tax havens (Vervynckt 2014).

In addition, it is important to note that EU development agencies/Ministries could be playing a much more significant role in advocating within their Government's for political action to address the issue of IFFs, which would in turn help to generate the required changes at the international level.

3.3 The catalytic role of untying aid and local procurement

Tied aid refers to the practice of donors requiring aid recipients to purchase goods and services from companies in donor countries. In recent years donor efforts to remove formal tying rules have intensified, promoted by a range of international commitments. There are however also challenges relating to the informal tying of aid – using procurement rules to bias awards towards national companies - which have to date not been addressed by international reform efforts, despite demands by developing countries.

So what is the case for the (formal and informal) untying of aid and how could it contribute to increasing the catalytic impact of aid?

The strongest evidence base supporting the untying of aid relates to its cost-effectiveness. Studies have found that as this form of aid does not involve competitive bidding it inflates costs by at least 15-30% (Clay et al 2007), with estimates significantly higher in relation to procuring food aid (Tschirley 2007) and especially technical assistance (Actionaid 2005).

The decision to tie aid also raises issues related to the suitability of the goods and services procured for recipient countries. The effectiveness of donor country experts is often impaired by limits to their knowledge of the country context they work in; equipment and materials sourced from donor countries may be difficult for recipient countries to maintain and replace; and the legitimacy of work to promote rights and strengthen civil society can be undermined if local organisations don't have sufficient leadership over programmes (Glennie and Rabinowitz 2013).

In addition to the implications for the aid programmes being implemented, untying also opens up valuable opportunities for stimulating economic activity in the recipient economy through the decision to procure goods and services from local providers. A range of studies relating to food aid have found that local procurement provides important economic opportunities to smallholder farmers (Harou et al 2013; Walker et al 2007; WFP 20111) as well as food processing sectors (Walker et al 2007) across a range of countries. Other studies have illustrated how local procurement can contribute to employment generation (Clay et al 2009) and promote general economic multiplier effects (PDT 2009).

The current evidence therefore suggests untying can generate significant benefits through improving cost effectiveness in procurement, allowing the most suitable goods and services to be procured and generating economic benefits through creating the possibility for local procurement.

Given this analysis it is a concern that significant volumes of EU aid remain formally tied and that local procurement by EU donors is very limited (see section 2). It is therefore critical that EU MSs make efforts to end their practice of formally and informally tying aid, there can be no more excuses for applying such archaic and wasteful practices. Agreeing to end such practices as part of their Addis Ababa package of policies could go a long way towards making EU aid more catalytic and showing the international community that they are serious about pursuing a new era for aid.

3.4 The catalytic role of delivering aid through country systems

Using the country systems of developing countries in delivering aid refers to the practice of delivering aid directly through Government budgets (referred to as budget support) or concretely engaging Government institutions in the management, oversight, reporting and delivery of aid programmes. This concept is one of the foundational elements of the Paris aid effectiveness agenda and was further addressed by the Accra, Busan and Mexico (see below). It has also been the main priority for developing countries in recent global forums addressing aid.

Evolving international commitments on using country systems for delivering aid

- Paris Declaration 2005 - Use country systems and procedures to the maximum extent possible
- EU Council Conclusions 2005 – EU to deliver 50% of aid through country systems
- Accra Agenda for Action 2008 - Use country systems as the first option for aid programmes
- Busan Partnership agreement 2011; Mexico communique 2014 – Use country systems as the default option.

The following statement from the 2011 Paris Monitoring Survey provides a very useful overview of the theoretical case for using country systems for delivering aid:

> *Experience shows that setting up parallel institutions to implement projects that do not reflect country needs and priorities leads to high transaction costs and can ultimately undermine the sustainability of development efforts. When aligned to partner countries' priorities and systems, aid can provide incentives and momentum to help strengthen capacity, enhance domestic accountability and contribute to more sustainable institutions. (OECD 2011a, p43)*

This theory makes a strong case for addressing "use of country systems" as part of an agenda for promoting catalytic aid. The important question then is what does the evidence from a decade of pursuing this agenda suggest about the actual impacts of efforts to use country systems on strengthening capacity, enhancing domestic accountability and pursuing development results?

The answer is that the evidence is generally supportive of these theories, especially when looked at on the basis of understanding that institutional change is an incremental process as such fundamental changes take time to emerge.

The main evidence base that is useful in addressing this question is that relating to budget support, the aid modality which most ambitiously uses country systems. Budget support has been the subject of a number of evaluations in recent years, and some of the main themes emerging from this literature are presented in the box below:

Overview of the findings of recent multi-country budget support evaluations

- Multi-country evaluation of sector budget support, (Williamson and Dom 2010) – found that this had helped to scale up service delivery significantly; it also facilitated improvements in planning, the budgeting cycle, financial management and accountability, though progress was uneven; it was though notable that the quality of service delivery was only weakly addressed (partly due to the approach of donors to policy dialogue) and SBS had failed to address accountability for services
- Multi-country evaluation of general budget support, 1996-2012 (Lawson 2014) – found that this has contributed in important ways to upgrading the capability of these governments to manage their public finances, to deliver services and to regulate economic activity, for the benefit of their citizens; it was though also found that policy dialogue had been not been effective, technical assistance wasn't well used and transaction costs continued to be higher than necessary.

The results of these evaluations illustrate that budget support has generally been found to contribute to a scale up in service delivery, a strengthening of financial management systems, improvements in the way resources are allocated and to introducing many of the ingredients required to promote improved accountability to citizens. Importantly, these impacts would have helped not only to have improved the effectiveness of aid delivery, but also the use of public resources in general, helping to illustrate the catalytic potential of this form of assistance.

As with all aid instruments, budget support is no panacea and these studies show that it has had important blind-spots, such as limits to its impact on accountability, the quality of service delivery and governance. It is though the case that to some degree the design of these programmes failed to adequately address these issues and these weaknesses are not inherent to budget support.

Given the achievements of aid delivered through country systems and its apparent catalytic potential it is a concern that EU MSs have only marginally improved their performance in this area over the last decade, and have also been reducing their use of budget support (see section 2).

It is therefore vital that the EU address their weakening commitment to delivering aid through country systems as part of their effort to promote catalytic aid. EU MSs should therefore include in their Addis Ababa FfD Summit package a commitment to reverse their decline in use of country systems and an ambitious target to reach in helping to drive these efforts.

4. Conclusion and recommendations

Despite the achievements EU MS have made on aid over the last decade, their performance on aid quantity and quality falls some way short of the commitments they have made since the adoption of the UN Millennium Declaration and the Monterrey Consensus on Financing for Development. Even more worryingly, over recent years there has been a backsliding in the EU's performance, with aid quantity falling across many EU MSs, development effectiveness commitments being quietly dropped and a self-interested and damaging approach to catalytic aid emerging.

As a result of this disappointing performance the EU's development reputation is arguably at its lowest point for more than a decade. Such a reputational deficit creates major challenges for the EU in its ability to leverage an ambitious agreement from the Addis Ababa FfD Conference. This in turn heightens the possibility of the FfD Conference failing to deliver on its ambitions, an outcome which may lead to a spiralling downwards of ambitions for the UN SDG and Climate Summits later in 2015.

However, it is not late for EU MSs to change this narrative on their commitment to aid and development finance and to contribute to an ambitious outcome for the FfD Conference and for sustainable development in 2015.

For the Addis Ababa Conference, the EU and the MSs should agree to offer a tangible and ambitious contribution by championing an aid and effectiveness agenda centred around concrete actions to unlock much needed development resources, including:

- **Meeting their existing aid targets** (0.7% for EU-15; 0.33% for EU-13) by gradually increasing aid to these levels by 2020 and submitting phased plans for doing so to the EC by end of 2015
- **Ending the use of inflated aid**, by stopping the counting of student and refugee costs in donor countries towards aid figures and by discounting interest payments from aid loans
- **Focussing** aid on poverty eradication results and achieving sustainable development outcomes
- **Taking action to increase aid to LDCs and commit to the current UN target of 0.15–0.20% ODA/GNI**, and setting themselves the even more ambitious target of providing at least 50% of total ODA to these countries.
- **Ensuring that comprehensive and strong development effectiveness tests are also applied to aid funding provided directly to the private sector** as a conditions of approving projects and ongoing disbursements; this should include a focus on the following principles:
  - Build on development effectiveness principles agreed in Paris, Accra and Busan
  - Demonstrate additionality and value for money
  - Share risks and minimise debt
  - Ensure transparency, accountability and participation at all stages
  - Ensure good corporate governance
  - The sustainable development principles of poverty alleviation and social development, equitable environmental sustainability and inclusive and sustainable economic development
- **Prioritise domestic resource mobilisation in using aid to catalyse other flows of development finance**, including addressing the international constraints to DRM
- **Immediately meet existing commitments to fully untie aid** on a formal basis, and commit to action to ambitious action to address the bias in aid contracting towards donor companies and promote local procurement
- **Reverse the recent decline in the use of country systems for delivering aid**, and agree to ambitious targets to help meet commitments to use these systems as a default option for aid delivery
- **Reverse cuts to budget support across EU MSs and deepen the focus of this instrument on addressing challenges relating to accountability and the quality of service delivery**
- **Address existing reform commitments in other aid effectiveness policy areas**, including promoting ownership, predictability, transparency and joint programming.

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