A Development Finance System for a New World Order

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Abstract: The current system of governing development finance flow (principally Official Development Assistance), while achieving significant and measurable outcomes is facing headwinds. Political support for international cooperation is waning, leaders of countries in the Global South are demanding a say at decision- making tables buoyed by their increasing geo-political leverage. This paper presents broad principles for reconsidering the basis of development cooperation and suggests specific policy proposals in line with these principles rooted in ownership and mutual cooperation and learning between all stakeholders. Firstly, humanitarian needs and the energy transition should be adequately addressed through a common fund, endowed with capital from levies on carbon-intensive industries. Secondly, infrastructure development should focus on lowering the cost of capital, and multilateral development banks should be reformed to create low-cost capital. Lastly, remittance flows should be prioritized for social protection and economic development, necessitating the reduction of remittance costs and improving payment services.

Keywords: Development finance, international cooperation, soft power, remittances, multilateral development banks.

In a truly multipolar world, characterised by increasing great power competition and the weaponisation of everything from sanctions, trade policy and vaccines, the foreign policy community is alive to the fact that we live in a new world order which is yet to be defined. But what does all of this mean for development finance? China's Belt and Road Initiative has transformed the scale and landscape of infrastructure finance. The EU's Global Gateway and G7 Build Back Better World Initiative have signalled a desire to use development finance, in part as a tool of soft power.

Official Development Assistance (ODA) still delivers significant and impactful programmes. For example, Gavi estimates that its childhood

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immunisation programmes have prevented more than 16.2 million deaths since 2000. Yet ODA now suffers from a governance and political narrative problem. Accountability for spending rightly lies with the electorates of OECD countries. While polling shows considerable support for aid, influential media narratives show an increasing scepticism of what many see as 'aid' or 'charity' to less developed countries. With increasing inequality within donor countries, charity, in the eyes of some, should begin (and in some cases end) at home. Unsupportive voices from 'recipient' countries where the impact - positive or negative - of this spending is felt are rising because they see it as an undignified and in some cases, postcolonial tool of influence over which they have limited control. Ghana's president, Nana Akufo-Addo, remarked that relying on European taxpayers to finance Ghana's health and education budgets "has not worked and will not work" for sustainable development. Meanwhile, financing needs have increased dramatically in the wake of climate change. Countries find themselves unable to borrow at affordable rates on international capital markets to fund massive infrastructure needs, and the institutions charged with providing this low cost finance - the Multilateral Development Banks have yet to rise to the scale of the challenge.

In this essay, I argue that we are living through a vacuum where the old paradigm of Official Development Assistance - dominated by the OECD countries - is of increasing irrelevance to the major challenges of our time and must evolve towards a new model of mutual cooperation and learning. But neither should we jettison decades of learning and impactful programmes - particularly at a time when financing needs are so great. Instead, we must leverage the instruments available to us in order to mobilise the significant capital needed to address the urgent energy transition imperatives and humanitarian crises while shifting the worldview that shapes policy and governance when it comes to development. I propose three shifts in how we think about development finance and three specific policy recommendations to action these shifts.

Development Assistance at a Crossroads

Development assistance has jointly served humanitarian needs and domestic political interests since its conception in the 1940s. In the immediate aftermath of World War II, European economies were rapidly deteriorating. Devastated countries were facing hunger and refugee crises, and the United States government openly feared 'exploitation' by a Communist Soviet Union. In 1948, the United States Congress developed the Marshall Plan, which eventually catalysed over $12 billion dollars to rebuild Western Europe – excluding Soviet Bloc cooperation and cleaving the continent further in half.

In the 1950s, Sir Arthur Lewis, advisor to the Leader of the British Labour Party, proposed that 1 per cent of donor country income should be

given to developing countries. Advanced internationally by the World Council of Churches and reduced to 0.7 per cent to focus only on public financial flows, the target was adopted by UN General Assembly Resolution on 24 October 1970. The express purpose was built on the UN Charter: "To create conditions of stability and well-being and ensure a minimum standard of living consistent with human dignity through economic and social progress and development."

Since 2000, Official Development Assistance has grown significantly. Yet, aid as a share of national income in the last decade has barely risen, showing little progress towards the original 0.7 per cent target. The most impactful aid programmes are astonishing. Gavi, the Vaccine Alliance, just announced its billionth vaccination - a programme that has saved 16.2 million lives. The Global Fund on AIDS, TB and Malaria has saved an estimated 50 million lives.

But the 2022 headline figures mask an underlying trend: barring aid for COVID-19 and in-country refugee costs (the latter of which is spent within the donor country), aid has largely stagnated since 2015 at a time when needs have increased dramatically. In 2022, ODA hit a peak of $204 bn, but more than 14 per cent of this was spent in donor countries on refugee costs. The proportion of Aid to Africa declined from 44 per cent in 2006 to 33 per cent in 2021 and in 2022, Aid to sub-Saharan Africa fell by 8 per cent in real terms.

This data also hides another story. The visionary Paris, Accra and Busan Aid Effectiveness Agendas in the early 2000s, which sought to build development finance around country ownership and transparency, have given way to a dynamic where some donors in the OECD's Development Assistance Committee (DAC) write the rules in their own favour around what can count as aid, with little to no oversight or input from 'recipient' countries. The DAC itself, rather than presenting a vision for how development cooperation should change in a changing world, is dominated by debates about how donors can do less while reporting more.

Contrast this with the increasingly bullish proposals from governments in the global south - encapsulated best in the Bridgetown Initiative spearheaded by Barbadian Prime Minister Mia Mottley, which seeks to reform the Bretton Woods Institutions, the governance of debt contracts and measures to unlock trillions in private capital such as addressing exchange rate risks.

Other sources of finance have become much more significant. Global remittance flows reached $647bn in 2022, of which $53bn went to sub-Saharan Africa. Loans from China to developing countries have surpassed $500 billion. G7 member states (not including the EU) make in nominal terms, down from nearly 70 per cent three decades ago. Actors such as China, Russia, Turkey and Saudi Arabia - which sit outside of the OECD - are conducting their own development and foreign policy programmes under very different terms.

Increasingly, leaders in the global south see their own dignity and self-sufficiency as a compelling domestic

political priority and the 'right' thing to do in their context. This is a refrain of Rwanda's President, Paul Kagame and Ghana's President, Nana Akufo-Addo. Kenya's leading climate diplomat recently asserted that they "don't want any handouts from the rich nations" in speaking about controversial loss and damage funds for climate change mitigation. Instead, they are focused on reforming the global financial architecture and asserting Africa's leadership to act on climate change. But this political trend belies a real worth truth. Many countries in the global south are strapped for cash, are facing debt distress, and are in great need of fiscal support.

One in five people on the planet now lives in countries in or at risk of debt distress. Those that default face the altogether. Those that don't have to make impossible choices about spending in order to make debt repayments - as Kenya did in April when it delayed civil servants' salaries in order to meet a Eurobond payment. The scale of financing required for emerging economies (excluding China) to transition their energy systems and meet human development needs amounts to $1 trillion a year by 2025 and $2 trillion by 2030.

But while advanced economies are facing a world of diminishing geopolitical influence, in part because they offer limited partnership opportunities for countries in the global south, they are sitting on stockpiles of surplus reserves (for example, $375bn in unused Special Drawing Rights), not to mention huge stocks of private capital looking for returns.

And the institutions they preside over - including Central Banks and the Credit Rating Agencies (which are private entities but could be regulated) are accused of undermining the flow of this capital to vulnerable countries through the conservative application of rules on monetary financing and apportioning unnecessarily high levels of risk to Africa countries. Yet this seemingly bleak picture could be challenged by the opportunities presented by the Green Energy Transition. Advanced countries recognise an urgent imperative to decarbonise their economies and simultaneously see the opportunity of a first mover advantage when it comes to developing cutting edge green technologies.

Emerging economies, particularly in Africa, have the natural endowments (60 per cent of solar potential, two-thirds of global cobalt production, and three-fourths of platinum) to enable these technologies and the aspirations to transform their economies through value addition of these resources. Some countries are rightfully leveraging this potential (though many cannot due to a lack of resources). Namibia recently banned the export of unprocessed lithium and other critical minerals, save small quantities approved by the minister responsible for mines. After banning the export of unprocessed lithium last year, Zimbabwe is now pushing its mining companies to produce battery-grade lithium locally. It appears the US is attuned to these shifts in power and circumstance. In April 2023, US National Security Adviser Jake Sullivan laid out

a new vision for US Foreign Policy - a 'new Washington Consensus' which he described as a modern industrial and innovation strategy - both at home and with partners around the world. One that invests in the sources of our own economic and technological strength, that promotes diversified and resilient global supply chains, that sets high standards for everything from labour and the environment to trusted technology and good governance, and that deploys capital to deliver on public goods like climate and health.

When it comes to development cooperation, reconciling these tensions and opportunities requires a reframing of the way that we think about development cooperation in three important ways:

First, the reality is that addressing the major challenges of our time - demographic shifts, migration, management of pandemic threats, the governance of technology and Climate Change will require cooperation and mutual dependence. These are 'laws of physics' that have no respect for political borders and which no amount of political narrative can defy. In a world where ecological breakdown and the rapid pace of technology are taking us into uncharted territories, those that will thrive will be those that can learn and adapt to those rapidly changing circumstances. Countries with a higher average GDP don't have an innate advantage when it comes to adaptation to change, and in many cases, those closer to everyday crises are those that are forced to adapt and learn faster. In this context, rich countries have a lot to learn about innovation from countries more vulnerable to the first waves of climate and pandemic shocks.

Second, the underlying assumption driving much development thought lies in the idea that 'developed' countries are 'models' for how societies should be managed and 'developing' countries need to become more like them. But the financial crisis undermined the credibility of this argument, and the increasing inequality that has ensued, accompanied by social breakdown, and 'deaths of despair' in these countries, shows this is not the case.

Third, a key objective of development cooperation should be the pursuit of trust and dignity between parties. That means valuing the strengths that each party brings and resolving not to use the power that money brings to undermine this trust. Ensuring a meaningful seat at the table in the governance of these resources and flows is critical. If no income group has a monopoly on the 'right' path to development, perhaps all countries can learn from one another.

Way Forward

Of course, the answers to better development cooperation have far deeper implications than the money that flows across borders. But if we take these assumptions seriously, they should also shape how we manage development finance. We should be clear-headed in thinking about the kinds of finance and financial flows that are best suited to different forms of cooperation and rebalance power in the governance of these funds. Here are three proposals.

Firstly, humanitarian needs are at an unprecedented scale, and climate shocks will make this worse. As a result, those with the greatest capacity to pay should contribute to crisis appeals as a matter of course. UN Agencies should not be forced to come up with a begging bowl to finance international crisis response. Instead, a common fund that automatically provides finance at the scale of humanitarian needs could be endowed with capital - perhaps from levies on carbon intensive industries and drawn down as required. But the often false distinction between 'humanitarian' and 'development' financing should be reformed towards a common objective of building resilience to shocks. With the DAC facing increasing irrelevance, it should be reformed to give a seat to a larger pool of stakeholders who govern the way in which these resources are managed together.

Second, infrastructure development should be driven by lowering the cost of capital. Countries should deploy the assets at their disposal to address this - initially by establishing a new G20 Commission on the impact of Credit Rating Assessments on enabling the energy transition. Multilateral Development Banks are a key tool in the financing toolbox by creating low-cost capital. They should be rapidly reformed through increased capital and steps to better leverage that capital - steps that triple World Bank lending - could potentially yield $1.2 trillion in low-cost lending by 2030.

The power of monetary finance should also be unlocked to address urgent capital needs through proposals such as hybrid capital instruments and SDR bonds. The AfDB and IDB have an advanced proposal on the table that would leverage just $2.5 billion of SDRs (less than 0.4 per cent of the last $650 bn allocation) into potentially $10 billion in additional lending while still allowing those SDRs to remain as reserve assets for the donors. This is a win-win proposal that is being held up by the technical rules of central banks. While small, this precedent-setting move could demonstrate a path to leverage the $375bn of unused SDRs at a ratio of 1:4 ($1.5 trillion) and potential future allocations (which can be made every five years without US congressional approval if under $650 bn).

Both proposals involve expanding low interest loans rather than aid or grants. As a result, accountability should lie with the citizens of the countries in which these loans are spent.

Finally, remittance flows (which amounted to $647bn in 2022) should be given precedence as a key driver of social protection and economic development. The lowering of remittance costs (both fees but also the friction and administration involved in making these transactions frictionless) should be identified as a priority to both increase these flows and reduce the money being paid to third parties. Financial innovation has made this possible in many cases within countries through online payment platforms and banking. This should be applied to international transitions through making remittance fees a fixed amount, not a percentage

of the principal (IMF), expanding the use of mobile payment services, coordinating regulation efforts for Anti Money Laundering in origin and receiving countries and standardising data exchanges.

In important ways, these shifts could both lock resources at the scale needed but also shift the power. Because rather than maintaining the power over resources with 'donor' countries who use them to pursue their own interests, these policies retain ownership and accountability with those responsible for and impacted by spending the money.

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