First session of the Preparatory Committee for the fourth International Conference on Financing for Development

Multi-Stakeholder Round Table Discussion on "International Development Cooperation"

Thursday, 25 July 2024, 15:00 - 16:30

Issue note

Background

The Addis Ababa Action Agenda (Addis Agenda) recognizes the important role of international public finance in financing sustainable development in complementing domestic resources. It underscores the need for scaled up international public finance for sustainable development, including through **official development assistance (ODA)** and **multilateral development bank (MDB) lending**. The Addis Agenda also includes commitments to explore **innovative approaches to mobilize additional resources**; promote **South-South cooperation**; and scale up **climate finance**.

The Addis Agenda stresses the critical role of ODA in supporting development efforts, particularly in the poorest and most vulnerable countries. It calls for scaling up ODA, with donor countries recommitting to their ODA targets, including 0.7% of gross national income (GNI), with 0.15% to 0.20% of GNI allocated to least developed countries (LDCs). Countries were encouraged to set a target of at least 0.2 per cent of ODA/GNI to LDCs, and developed countries further committed to reverse the declining trend of ODA to the LDCs.

The Addis Agenda also calls for improving the quality, impact and effectiveness of all forms of development cooperation, and emphasizes the need to better align development cooperation with national priorities, reduce aid fragmentation, and enhance the use of country systems to ensure effective and impactful aid delivery.

Member States recognize the pivotal role of multilateral development banks (MDBs) in providing long-term financing and supporting countercyclical financing during crises and call upon MDBs to adapt and expand their financial capacities to address the growing investment needs of developing countries. This includes increasing paid-in capital and developing new financial instruments. The Addis Agenda further calls on MDBs to adapt and be fully responsive to the sustainable development agenda. It stresses that development banks should: i) make optimal use of their resources and balance sheets; and ii) encourages them to examine their role, scale and functioning to improve their contribution to the sustainable development agenda. It further calls on development banks to develop graduation policies that are sequenced, phased and gradual, and to help ensure that countries have access to sufficient affordable finance after graduation.

To bridge the financing gap for sustainable development, the Addis Agenda highlights the importance of innovative financing mechanisms, such as blended finance, to mobilize additional resources for development projects. It suggests that ODA should be used strategically to leverage other public and private resources. However, it also underscores risks associated with blended finance, noting the importance of country ownership, as well as well-designed instruments that share both risks and reward fairly and include clear accountability mechanisms.

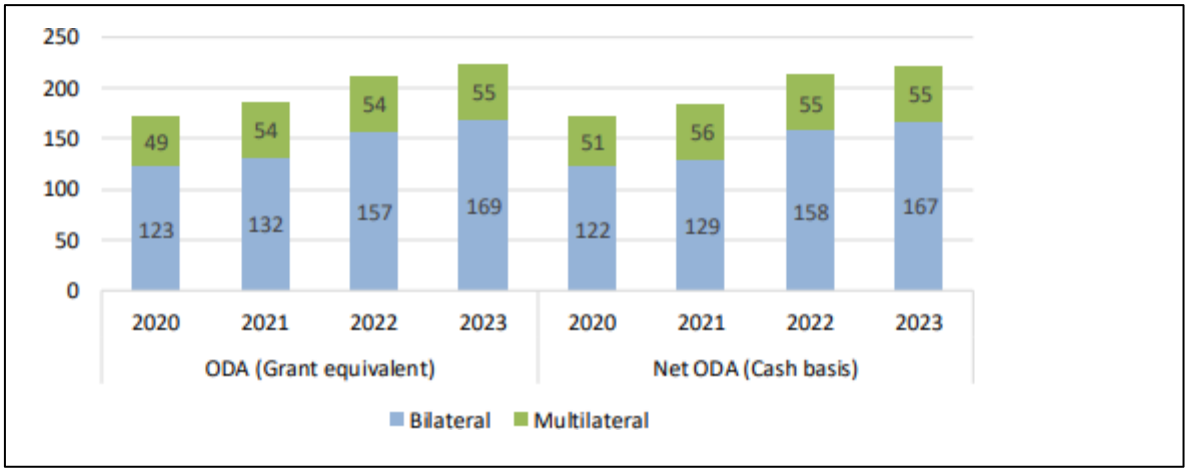
The significant role of South-South cooperation in promoting development is acknowledged. Developing countries are encouraged to share knowledge, skills, and resources through South-South and triangular cooperation. These forms of cooperation include focus on capacity building, technology transfer, and mutual learning.

Furthermore, addressing climate change and promoting environmental sustainability are integral to the Addis Agenda's vision of international development cooperation. Member States commit to increasing financial flows to support climate change mitigation and adaptation efforts in developing countries. This includes meeting the financial commitments made under the United Nations Framework Convention on Climate Change (UNFCCC). In addition, international development cooperation should be aligned with climate and biodiversity goals to ensure that development efforts contribute to environmental sustainability.

How have we done?
Key trends

Official development assistance has risen to record highs in recent years, but still falls significantly short of commitments, and is under pressure to respond to growing crisis response needs (figure 1). Official development assistance (ODA) reached a record high of $223.7 billion in 2023, but at only 0.37% of donor country gross national income (GNI), it remains well below the UN target of 0.7%. In addition, the sharp increases in recent years are largely attributed to a surge in donor countries' spending on processing and hosting refugees, as well as aid for Ukraine. Bilateral aid to least developed countries (LDCs) increased to $37 billion, but total ODA to LDCs remains below the target of 0.15-0.20% of GNI.

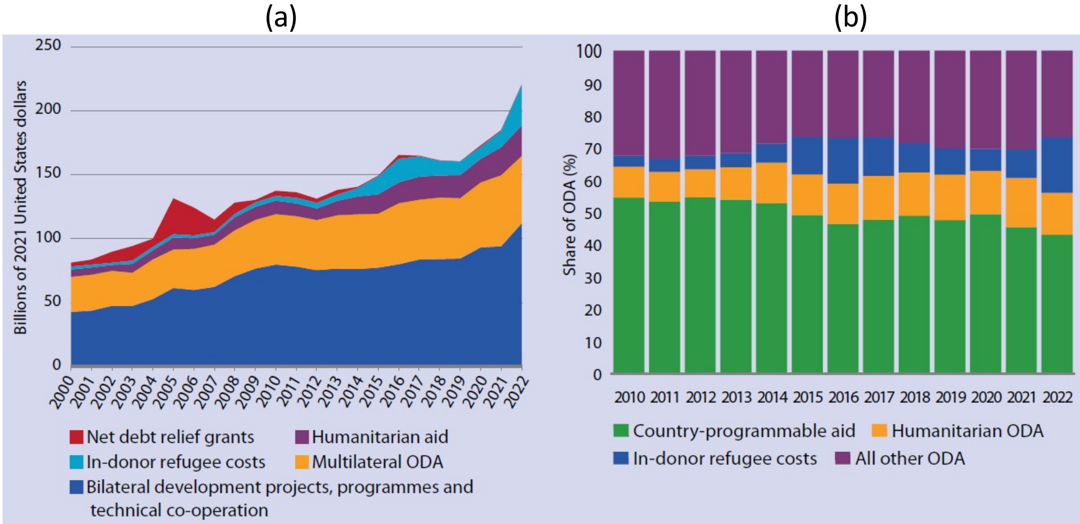
Figure 1. Official development assistance, 2020-2023 *(Billions of United States dollars, 2022 constant prices)*



Total net ODA to developing countries more than doubled in real terms compared to two decades ago (figure 2). However, there are growing concerns that in a more crisis-prone world, persistently higher spending on refugees and humanitarian aid will come at the expense of support for long-term SDG investments.

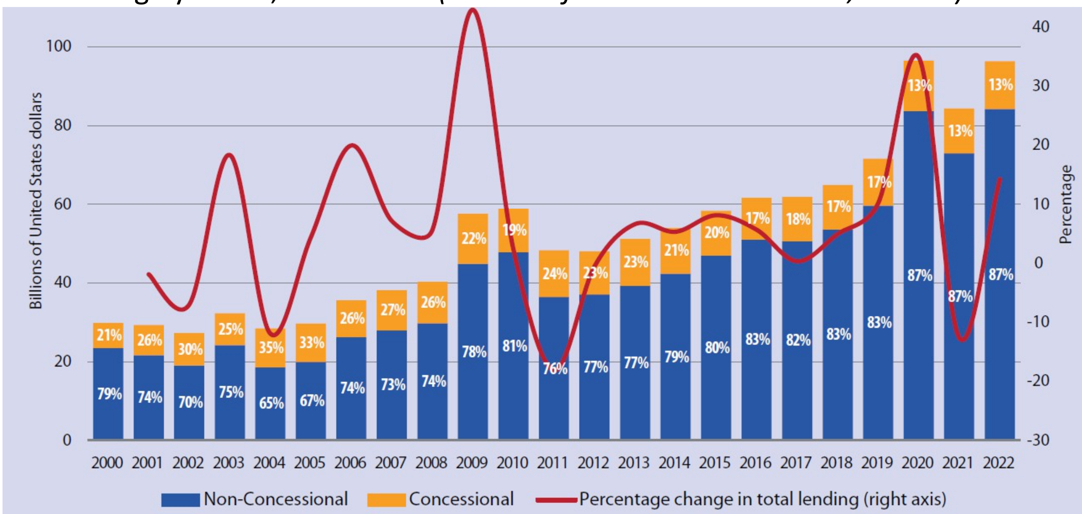
Figure 2. (a) ODA on a cash basis by component, 2000–2022 *(Billions of United States dollars, 2021 constant prices)* and (b) country programmable aid, humanitarian ODA and in-donor refugee costs, as shares of social development assistance, 2010–2022 *(Billions of United States dollars, 2021 constant prices, and per cent)*

(a) (b)



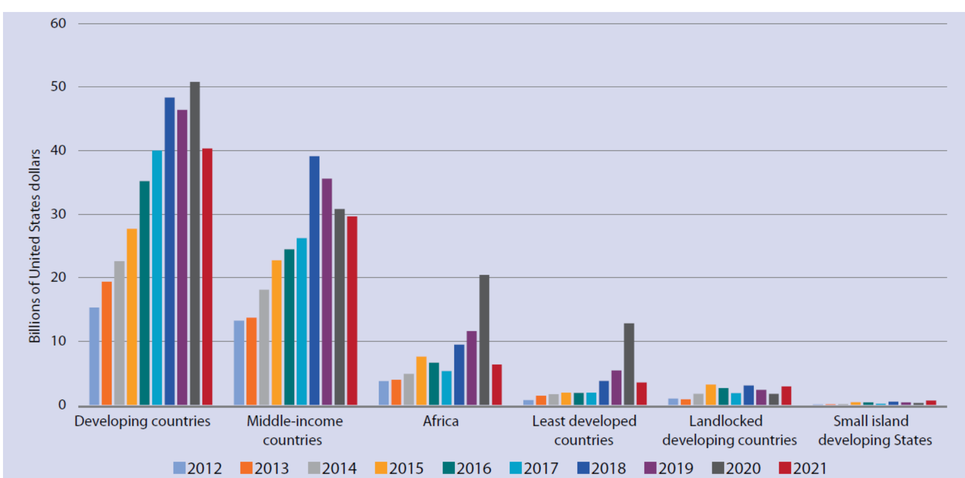
Multilateral development banks (MDBs) have significantly expanded their lending over the last 20 years, although concessional funding has declined (figure 3). Annual disbursements increased from $30 billion in 2000 to $96 billion in 2022. While concessional finance as a share of total MDB lending to developing countries rose in the early 2000s, it has since declined from a peak of 35 per cent in 2004 to 13 per cent of total MDB lending in 2022. Similarly, the share of grants to LDCs and SIDS has declined from peaks seen in the 2000s. This trend may reflect the challenge of providing higher volumes of financing with no associated increase in the volume of donor contributions, leading to fewer concessional resources.

Figure 3. Lending by MDBs, 2000–2022 *(Billions of United States dollars, current)*



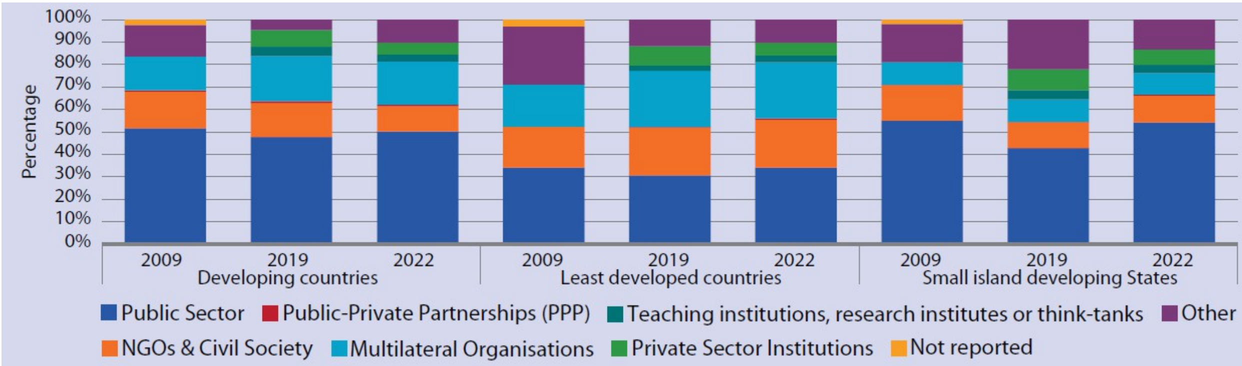
While blended finance has grown over the last decade, amounts mobilized remain far below expectations (figure 4). Between 2012 and 2022, total private finance mobilized by bilateral and multilateral development finance providers grew by an average of 12.55 per cent annually, to reach $61.5 billion in 2022. Of the total mobilized, 55.5 per cent targeted the energy and banking sectors, while 5.6 per cent went to projects in social sectors. The lower share of blended finance in social sectors largely reflects the lack of a commercially viable financial return in many social sector transactions.

Figure 4. Amounts mobilized from the private sector by social development finance interventions, 2012–2021 *(Billions of United States dollars, current)*



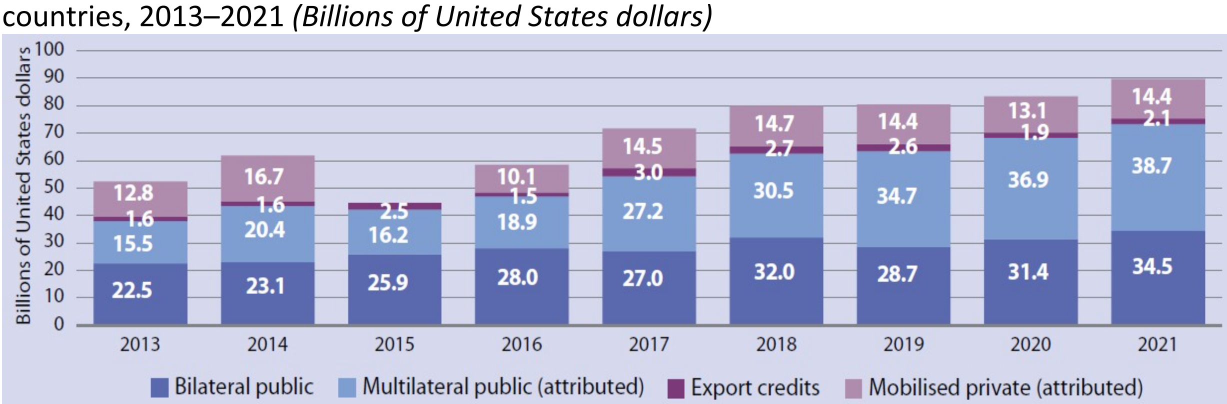
Global progress in improving quality, impact and effectiveness of development cooperation has been mixed, with less than half of ODA channeled through the public sector of recipient countries (figure 5). Eighty-two per cent of 2022 Development Cooperation Forum Survey respondents reported the adoption of national development cooperation policies, up from 72 per cent in 2016, and highlighted their role in mobilizing and aligning not only ODA but also other modalities of international development cooperation. Yet, before the COVID-19 pandemic, the alignment of development partners with partner country priorities and country-owned results frameworks had been declining.

Figure 5. Gross bilateral ODA disbursements by channel *(Percentage of total)*



Mobilization of climate finance falls short of what is needed to effectively address the scale of climate changes and remains grossly inadequate for the most vulnerable countries (figure 6). There are large investment gaps in climate change mitigation and adaptation as well as in disaster risk reduction. The latest OECD assessment of progress showed that climate finance provided and mobilized amounted to $89.6 billion in 2021, an increase of over 70 per cent compared to 2013, but still short of the 2009 commitment of developed countries to jointly provide and mobilize $100 billion a year by 2020 to support climate action in developing countries.

Figure 6. Climate finance provided and mobilized by developed countries for developing countries, 2013–2021 *(Billions of United States dollars)*



Actions and Challenges

Official Development Assistance (ODA)

Since the adoption of the Addis Agenda, ODA provided by OECD DAC members has significantly increased, but remains well below commitments. There is also a growing recognition of need to consider indicators beyond income, including vulnerability, in allocation decisions, compounding concerns over the size of the available ODA envelope. Measures of vulnerability are not yet considered in allocation decisions for concessional financing. Enhanced support for these countries is critical to addressing their unique development challenges and ensuring they are not left behind. LDCs and small island developing states (SIDS) require more concessional resources and grants.

Shifts in the modalities of ODA delivery have had profound impacts on allocation of resources, country ownership and effectiveness. For example, in-donor refugee costs and humanitarian aid as a share of total net ODA increased from around 9 per cent in 2000 to 25 per cent in 2022, while budget support, which is particularly well aligned with country priorities, has remained extremely low over the past decade, reaching just 3.35% in 2022, representing an increase of only 0.62% since 2015. Increasing budget support would not improve donor alignment with partner countries' priorities, it could also help to strengthen public financial management capacities.

Multilateral Development Banks (MDBs)

Since 2015, MDBs have continued to provide affordable long-term finance for developing countries, playing a critical countercyclical role during economic downturns and crises. MDBs' role in financing infrastructure and social programs has been pivotal in promoting sustainable growth.

Lending by MDBs increased significantly over the past two decades, from $30 billion in 2000 to $96 billion in 2022, although concessional funding decreased. In response to calls by the international community to massively scale up long-term financing for the SDGs, MDBs are implementing or considering reforms to increase lending capacity, improve lending terms, and better align operations with the SDGs. In total, these reforms could yield $300-400 billion of additional lending capacity over the next decade. [1] MDBs are also including improving the measurement of development and climate impact.

Nonetheless, more is needed. The paid-in capital bases of MDBs have not increased proportionately with the global economy or growing investment needs. This limits their ability to scale up financing to meet the escalating demands of sustainable development projects. The upcoming 21st Replenishment of the World Bank's International Development Association (IDA) will need to be the largest ever to help meet SDG financing needs. Mobilizing sufficient resources

[1] FSDR 2024 p 106

for this replenishment is crucial for continuing support to the world's poorest countries and addressing their critical development challenges.

The Addis Agenda had already encouraged the MDBs to make optimal use of their resources and balance sheets and to update their policies in support of the SDGs. Building on the progress achieved since then, the fourth International Conference can galvanize further ambitions to make the MDB system fit for purpose, including encouraging more cooperation among MDBs as well as between MDBs and other public development banks (PDBs). This includes fully aligning their activities with client country priorities and strategies, e.g., by strengthening country platforms anchored in existing national processes, such as integrated national financing frameworks (INFFs) work as a line with recommendations in the SDG Stimulus.

Blended finance and other innovative mechanisms

Despite some progress in leveraging private finance using public funds, blended finance has not been successful in catalyzing private investment at scale. Approximately $213 billion in capital has been mobilized, far below the trillions projected to be unlocked a decade ago. In addition, only a small proportion of this mobilized capital has been channeled to LDCs.

Reforms at MDBs have focused on new ways to raise private resources, with some considering numerical targets. However, it is likely that such targets would incentivize deals that are easier to implement with high leverage ratios, which are more likely to be lower risk transactions, bypassing LDCs.

A new approach to blended finance is needed, tied to principles laid out in the Addis Agenda, with a primary focus on development impact rather than quantity or degree of leverage (which favors lower-risk projects, often with lower development impact). This would also include ensuring alignment with country priorities as part of broader national sustainable development strategies; measurement of the cost of blending versus other financing mechanisms; and designing instruments to ensure that the public sector is not overcompensating the private partner. Establishing robust frameworks and accountability measures to track and report on impact is essential.

South-South Cooperation

South-South and triangular cooperation have gained prominence, contributing to development finance and technical assistance since 2015. These partnerships leverage shared experiences and resources among developing countries to address common challenges. The establishment of new South-led development banks, such as the New Development Bank and the Asian Infrastructure Investment Bank, has expanded the scope and reach of South-South cooperation. These institutions provide alternative sources of financing and promote regional development initiatives.

There is a need for better measurement and coordination of South-South cooperation efforts to maximize their impact. Standardized reporting and evaluation frameworks can enhance transparency and effectiveness. Mobilizing sufficient resources for South-South cooperation initiatives remains a challenge. Ensuring sustained funding and political commitment is essential for scaling up successful projects and programs.

Quality, Impact and Effectiveness of International Development Cooperation

Progress towards high quality and high impact international development cooperation has been uneven since the adoption of the Addis Agenda. Development strategies of many traditional donor countries have decreased their emphasis on effectiveness principles since 2015. The share of ODA reaching partner countries has plateaued, and there has been limited progress on country ownership, though there have been improvements in untying aid. The growing and increasingly diverse set of bilateral, multilateral and philanthropic development finance providers is contributing to growing fragmentation and higher transaction costs. This changing landscape calls for a new shared understanding of guiding principles and practices of effective development cooperation. There is need for a renewed inclusive debate to adjust, translate and evaluate principles for high-quality and high-impact international development cooperation to facilitate their application in diverse country contexts.

Climate Finance

Climate finance has grown since the adoption of the AAAA, with an increasing share targeting biodiversity goals. The creation of the Loss and Damage Fund marks a significant milestone to support climate adaptation and mitigation efforts, particularly in vulnerable regions. Multilateral climate funds, such as the Green Climate Fund and the Global Environment Facility, have played a crucial role in mobilizing resources and supporting climate action in developing countries.

Despite the growth, climate finance flows remain grossly inadequate, particularly for the most vulnerable countries. Commitments have yet to be fully met, and the global climate finance architecture is fragmented, creating coordination and access challenges. Addressing these gaps requires stronger international cooperation and increased financial commitments from developed countries. Developing countries often face barriers in accessing climate finance due to complex application processes and stringent requirements. Simplifying access and ensuring timely disbursement of funds are essential for effective implementation of climate projects. Developing countries have also called for climate finance to be new and additional, not diverting funds from non-climate development finance.

The way forward and guiding questions for discussion

A number of solutions have been proposed to address the numerous challenges facing international development cooperation. To fulfill decades-old ODA commitments, proposals have been made to set and monitor time-bound ODA increases tailored to recipient needs, including targets for quality cross-border ODA. Enhancing the capital bases and accountability frameworks of MDBs could support a bigger and better MDB system. In a fragmented international development cooperation landscape, there have been calls for new multilateral agreement on high-quality and high-impact development cooperation principles and improved coordination between South-South and North-South cooperation. To ensure that climate finance is new and additional to ODA, new goals and analytical approaches are needed. The fourth international conference on Financing for Development presents an opportunity to galvanize political support to fulfill longstanding ODA commitments and ensure support is effective and fully aligned with country priorities and development strategies.

1. ODA

- How can the fourth international conference on financing for development help ensure increases in ODA tailored to the specific needs of different recipients? Are additional targets needed for support?
- How can country ownership be strengthened? How can the proportion of ODA allocated to general budget support be increased to bring much needed improvement in the alignment with partner countries' development strategies and long-term needs?
- Should vulnerabilities be considered more systematically in allocation decisions? What would this entail?
- What strategies can ensure that ODA allocations effectively support SDG needs in countries?

2. MDBs

- What steps can be taken to set a plan for paid-in capital increases for MDBs to meaningfully scale up their lending capacity, especially for LDCs and other vulnerable countries?
- How can the international community encourage more cooperation among MDBs as well as between MDBs and PDBs, to work as a system in service of development and climate impact, reduce risk on individual banks and better target resources according to comparative advantage?
- How can SDG impact be enshrined at the core of development bank operations and investments? Do internal incentives need to be adjusted, and how should this be done?

3. Blended finance and other innovative mechanisms

- What new approaches to blended finance can be developed to scale up blended finance while focus on sustainable development impact and country ownership?
- How can the lessons learned from the current application of blended finance be used in developing a new blended finance framework?

4. South-South Cooperation

- What measures can enhance the coordination and impact of South-South cooperation in achieving the SDGs?
- How can the complementarity between South-South and North-South cooperation be enhanced to foster more cohesive and effective development strategies and improve their collective impact on sustainable development goals?

5. Quality, Impact and Effectiveness of International Development Cooperation

- How can new momentum be built behind principles of effective, high-quality and high impact development cooperation in order to effectively respond to evolving global challenges?
- What measures can be taken to reduce fragmentation and enhance ownership of international development cooperation?

6. Climate Finance

- How can climate finance commitments be fulfilled and scaled up to meet the needs of the most vulnerable countries?
- What reforms are needed to streamline the global climate finance architecture and improve access for developing countries?
- How can an ambitious new combined climate and development finance goal be developed to ensure climate finance additionality?