



## **G7 Finance working paper on aid effectiveness**

### **G-7 FINANCE WORKING PAPER : AID EFFECTIVENESS**

The Monterrey Conference on Financing for Development endorsed the concept of partnership between developing and developed countries, with all stakeholders committed to increasing both the volume of aid and the effectiveness of aid with a view to achieving the Millennium Development Goals (MDGs). Our challenge is to work together with developing countries to implement the most valuable lessons we have learned from our many years of experience in supporting development: sound economic policies, good governance and access to world markets form the basis of long-term prosperity. To achieve this objective and to increase aid effectiveness, this paper outlines some key principles and actions in four important areas:

- ◆ to improve the quality of poverty reduction strategies, particularly the need to better reflect a credible plan to achieve lasting growth;
- ◆ to make further steps to improve harmonisation, building on the February 2003 Rome Declaration;
- ◆ to focus development assistance on measurable results; and,
- ◆ to send a clear signal on the importance we attach to good governance in considering the allocation of our international assistance.

Beyond providing aid, however, developed countries have a responsibility to afford poor countries the opportunity through trade to earn the resources that will sustain growth and poverty reduction. We are all committed to achieving the objectives set out in the Doha Development Agenda and to meeting its overall timetable. Further trade liberalizing actions by developing countries themselves are also critical to promote lasting growth and poverty reduction.

#### **A. Enhancing the role of poverty reduction strategies**

1. We recognize that poverty reduction strategy papers (PRSPs) have provided a valuable framework for increasing country ownership of reform efforts, measuring progress towards the MDGs, and for increasing poverty reduction expenditures, including through debt relief provided under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. However, this is a work in progress and improvements to the process are still needed. Developing countries, with the support of the international community, must now make efforts to improve and adapt PRSPs, with a particular emphasis on the following areas:

- ◇ Prioritizing sources of, and removing impediments to, growth. Most countries in Africa need to double their GDP growth rates to achieve the poverty reduction MDG. However, experience suggests that PRSPs do not sufficiently prioritize actions necessary to drive productivity growth. In particular, policies and institutions that contribute to increased competitiveness, link macro- and micro-economic policy reform, and enable private sector led growth, have all been under-represented in the PRSP dialogue. We will work with recipient countries and the IFIs to support improvements in PRSPs on these issues.
- ◇ Addressing corruption. Corruption continues to impede economic growth, deter foreign investment and undermine the effectiveness of public resources. We call on the IFIs to support governments in the development of anti-corruption plans, underpinning their poverty reduction strategies. These plans would build upon and operationalise international and regional conventions and agreements against corruption. Implementation of these plans should be monitored through an internationally agreed assessment framework.
- ◇ Strengthening public expenditure management and accountability. Many aid recipients, particularly those in sub-Saharan Africa, continue to have chronic weaknesses in expenditure management and, in most cases, the PRSP is not in line with the national budget process (i.e., from a timing, capacity and resource allocation

perspective). We call on all low-income countries' governments to develop, with the IFIs' assistance, country-led action plans for better public financial management and accountability as part of their poverty reduction strategy. All PRSPs should include such action plans with measurable targets. For countries making such efforts, we commit:

- to increase our assistance and undertake efforts to ensure our aid is more predictable;
- to align our own approaches with these plans and harmonize our requirements, where appropriate; and,
- to increase our use of country-systems where these meet appropriate fiduciary standards.

We also call on the IMF and World Bank to further increase their efforts in this area, to streamline and better coordinate their tools, to strengthen their assessment mechanisms, and to report on progress at the Annual Meetings.

2. Aligning capacity building efforts to PRSP goals. We recognize the need to help countries identify and address the barriers to effective implementation of their poverty reduction strategies. In particular, we need to align our capacity building efforts to address these gaps. Efforts to tackle corruption and to improve expenditure management, as noted above, are two important areas in this regard. Another key area identified by developing countries is trade-related technical assistance. The World Trade Organization (WTO) has created the Global Trust Fund and has improved its training programs. The World Bank has noted that trade needs to be better integrated into development strategies, including PRSPs and World Bank Country Assistance Strategies (CAS). We urge the World Bank to follow up on its own conclusions and take action to address trade policy capacity building – both with respect to its own work on the ground and in cooperation with the WTO and other relevant bodies. This includes working to improve follow-up on work undertaken in the context of the Integrated Framework for Least Developed Countries.

3. Expanding the use of country-driven development strategies. We strongly encourage all developing countries that are not currently developing PRSPs, or undertaking a similar exercise, to develop a nationally owned plan to address poverty. We encourage IFIs to assist those countries, particularly middle-income countries, which have begun this process and to consider what incentives may be needed to engage additional countries. The IFIs could be instrumental in promoting the adoption of development indicators in middle-income countries as well. This would allow for a more coherent establishment of indicators and measurements systems across countries.

## **B. Harmonizing Our Efforts**

4. Alignment of aid with poverty reduction strategies. Efforts have already been made to align donors' strategies and interventions with recipients' poverty reduction strategies. There is strong evidence that the IFIs in particular are using the PRSP or country-owned national strategies as a basis for their own country strategies. This has contributed to strengthened aid effectiveness while also enhancing country ownership over the programs financed by aid. In countries with PRSP or equivalent processes, we agree to make further efforts to link our assistance with their priorities.

5. Harmonizing procedures. Harmonizing donors' administrative procedures and building on country systems and approaches will relieve recipient governments from unproductive duplication of administrative tasks required by donors, both bilateral and multilateral. We agree to build on the outcomes of the recent Rome High level Forum and the work to date of the OECD's Development Assistance Committee (DAC), the World Bank and other multilateral development banks (MDBs). In particular, we agree to call on the DAC to monitor progress on harmonization efforts and, if necessary, to consider to work – together with the MDBs – on specific recommendations and timeline for further harmonization efforts, bearing in mind the need to set standards at the highest rather than the lowest denominator. We urge the DAC to consult recipient countries on this matter and incorporate their opinions when they make such recommendations. Progress towards achieving commitments must also

be monitored and regularly reported on.

6. Untying aid. In order to increase the effectiveness of development assistance, we call on the DAC to ensure the effectiveness of the untying recommendation and to review the extent to which all members have taken steps to fully implement it, in spirit and in action. We urge all DAC members to accelerate the implementation of this recommendation. Building on this outcome, we expect the DAC to continue to explore options for further progress in this area and to report on progress in implementing current agreements.

### **C. Focus on Results**

7. Our ability to demonstrate that aid works directly affects the level of public support for ODA. We welcome the MDBs initiative towards better measuring, monitoring and managing of results, and we urge full and time-bound implementation for country assistance strategies, sector policies and specific financing operations. We support a role for the Development Committee in discussing annual progress towards achieving the MDGs. Since achievement of the MDGs depends on developing countries creating an environment for growth, improved productivity, and strong governance, it will also be important to monitor progress on these as well. To move this agenda forward we believe additional efforts are needed in the following areas:

◇ New country indicators. The World Bank and UN, who are undertaking cooperative work to translate the global MDGs into sectoral goals, are supporting the development of PRSP goals for individual countries. More needs to be done, including improved coordination with other institutions, to ensure relevant baseline data is collected, appropriate intermediate benchmarks are established and a results-based system is in place to measure outcomes, in particular common country outcomes that can facilitate cross-country comparisons, where possible. The World Bank should also develop indicators to measure the environment for growth, improved productivity and strong governance, in coordination with other

institutions;

- ◇ Supporting statistical capacity. Operational plans for establishing baseline data and measurable indicators in priority areas are critical to success of the PRSP process. We commit to support the World Bank, PARIS 21, and other institutions in their efforts to reinforce their capacity building work with developing countries in the area of collecting and analysing statistics, especially in those countries at risk of missing the MDGs; and,
- ◇ Improving and broadening the results approach. We call on the World Bank to improve existing mechanisms, for instance, transforming the Country Assistance Strategy to more results-based documents and strengthening the overall Performance-based Allocation exercise, including more robust Country Policy and Institutional Assessments (CPIA). We will support the inclusion of results indicators, similar to those of IDA 13, for other large multilateral funds, starting with coming replenishments. We also commit to work in the DAC on a timeframe to extend such initiatives to our bilateral agencies.

#### **D. Promoting and Rewarding Good Governance**

8. Recent work by the OECD/DAC, World Bank and others have highlighted the limited progress on structural and governance reforms that threaten the attainment of MDGs in many countries. Of particular concern, the Bank's 2002 CPIA process found that two-thirds of low-income countries have a business environment that could seriously inhibit domestic and foreign investment, including serious shortcomings in respect for property rights and rules-based governance. Public sector governance, including control of corruption, remains a concern in more than three-quarters of low-income countries. We consider improvements in the environment for private sector activity and public sector management as prerequisites for aid effectiveness.

9. Improving the selectivity of aid. We commit to increase selectivity in our assistance, focussing our aid on the poorest but best performing countries. A

fundamental principle of the Monterrey Consensus and the New Partnership for Africa (NePAD) is that developing countries will commit to improve governance. We renew our promise to scale-up the volume of our aid to governance performance. This will lead to increased, and more predictable, aid for those countries committed to reform. By coordinating our efforts in this regard, we also increase the overall incentive to improve policies and pursue good governance. We will also work to reinforce the capacity of weak performers, while recognising the needs of poor people in these countries. To support our efforts, we agree to call on the IFIs to work towards more transparent and objective means to identify good performers so as to strengthen the incentive of all aid recipients to improve governance. We support current efforts underway in the DAC and MDBs to improve indicators for governance, given the known problems related to adequacy, reliability and comparability. To help move this agenda forward, we will ask the World Bank to publish individual CPIAs.

10. Strengthening transparency and accountability. Too many countries refuse to allow publication of their IMF Article IV consultations (44 countries in FY2002, including 15 of 33 sub-Saharan African countries and 7 of 10 North African and Middle Eastern countries) and World Bank CASSs. We will press to establish presumption of publication of all country surveillance, program reviews, reports and strategies, including Article IV, PRGF/SMP staff papers, and all MDB country strategies, while taking into account the impact on deletion and correction policy. This will help promote local debate and ownership over the reform process. We will also ask that they require all IMF exceptional access cases to include publication of staff reports, and a separate report for each IMF exceptional access case that lays out clearly the justification of such access, which also would be published. We will urge that they seek full disclosure of MDB performance allocation systems, and ensure that all fiduciary and governance diagnostics are made public. With respect to Africa, we renew our support to the NePAD process and look forward to progress in the implementation of the African Peer Review Mechanism, including its governance aspects. We will ask the IFIs to look for opportunities to coordinate their monitoring and surveillance mechanisms with NePAD's own work.

11. Enhancing participation. Recent work by the IMF and World Bank suggests the quality of in-country debate and consultation on key issues, such as IMF programs and PRSPs, while improving in some cases, nevertheless remains uneven. Broadening this dialogue to include Parliamentarians, private sector and civil society organizations, local administrations and other important groups is key to building accountability and ownership over reform agenda. We urge developing countries, assisted by the MDBs and other organizations, to address this issue. We are committed to help facilitate this process, including providing support to country-led efforts to analyse the poverty and social impact of key policy reforms.

## **E. Increasing Trade Opportunities**

12. The World Bank estimates that global income would rise by over \$800 billion from free trade in all goods, of which close to two-thirds of these benefits would flow to developing countries. Increasing trade opportunities for developing countries through the Doha Development Agenda is therefore essential if developing countries are to achieve their Millennium Development Goals. We are committed to seize the opportunity provided by the Doha Round.

13. Enhancing "South-South" trade. We note that developing countries now pay over 70 percent of their trade duties to each other; tariff rates on South-to-South trade are nearly four times higher than South-to-North trade. Clearly, more needs to be done to promote trade amongst developing countries, including support to regional cooperation and infrastructure projects.