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debt and development

Covid-19 and Official Development Assistance

Current issues and challenges

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Executive Summary

The Covid-19 pandemic is in danger of seriously undermining the capability of developing countries to achieve the Sustainable Development Goals (SDGs). Helping these countries to respond adequately to the health emergency and economic fall-out requires a broad range of systemic measures and close international cooperation. Official Development Assistance (ODA) could play a crucial role in tackling the immediate impacts of the coronavirus crisis and supporting a recovery centred on human rights, gender equality and a just transition.

After a brief overview of the state of play of ODA, drawing on the most recent data available, this briefing paper looks at the initial responses to Covid-19 of the main bilateral providers of ODA. It finds these responses are significant, representing roughly 20 percent of total bilateral ODA. However, it remains unclear to what extent these resources can be considered as ODA and whether they are in fact additional to the resources that had been committed before the start of the pandemic.

Given the lack of ambition voiced by members of the Organisation for Economic Co-operation and Development's Development Assistance Committee (DAC) in their joint statement to 'strive to protect aid budgets', it is all but certain that aid spending will remain at current levels in the near future. However, in the context of expansionary fiscal and monetary policies in donor countries and the moral imperative to address the global consequences of the coronavirus outbreak, this paper makes the case for an urgent upscaling of ODA as part of a more comprehensive, systemic multilateral response.

A second part of this briefing paper looks at a number of key trends that undermine the quality of ODA and risk being exacerbated by donor responses to Covid-19.

1. Donor providers have been preferring loans over grants in recent years, while the level of concessionality (the degree of 'softness' of a credit reflecting the benefit to the borrower compared to a loan at the market rate) has decreased. As many developing countries are facing unsustainable debt levels and all other sources of development finance are simultaneously drying up, donors need to consider grant-based finance as the default option.
2. Policy makers and experts are calling for a strengthened role of development finance institutions (DFIs) and blended finance. Since evidence of the impact and scalability of such financing options is hardly robust, this debate should focus on a development effectiveness framework to ensure scarce ODA is used where it is needed most and can achieve most impact.
3. Debt relief is expected to return as an aid modality as calls to go beyond the limited debt standstill agreed by the G20. These efforts should result in additional fiscal space to finance policies that are centred on human rights and gender equality, and should kick-start a transition to climate resilient and sustainable economies.
4. ODA budgets are used to finance solutions that equally benefit donor and developed countries, such as vaccines and treatments for Covid-19. This risks undermining the credibility of ODA as a measure of donor effort to support developing countries and as a key tool for international accountability of providers.

In the final part of this briefing paper, we present a number of key recommendations for ODA providers to help maximise its potential as a key resource in tackling the current crisis. These policy actions centre around scaling up the resources available to developing countries to match the challenges, improving the quality of ODA to align with developing countries' needs in the face of the pandemic and rethinking 'aid architecture' to bounce-back better.

1. Introduction: interrelated crises

In the face of the Covid-19 pandemic, the world is witnessing a global healthcare crisis that is unleashing interrelated humanitarian, food security, social, economic, ecological and financial crises. In countries across the world, millions of people have been infected by a disease that we are still struggling to understand and cure.¹ Meanwhile, many developing countries are feeling the economic effects of the pandemic, including record-breaking capital outflows, commodity price drops and escalating debt service costs. This was already happening before they even saw their first Covid-19 patients in their countries. At the time of writing, 100 countries had requested emergency financing from the International Monetary Fund (IMF). Even before Covid-19 was characterised as a pandemic, half of the Lower Income Countries were already assessed as being at high risk of or in debt distress.² The International Labour Organization (ILO) estimates that nearly half of the global workforce stands in immediate danger of having their livelihoods destroyed. More than 400 million companies worldwide risk serious disruption and informal economy workers are suffering huge damage to their capacity to earn a living.³ The World Bank estimates between 40 and 60 million people may be pushed into extreme poverty in 2020 as a result of Covid-19.⁴

The impacts of these developments will be hardest felt by the most vulnerable in society, particularly women. Women are often overrepresented among healthcare workers, **society's first line of defence against Covid-19. They are also often employed in other sectors that are now heavily impacted by lockdowns such as domestic services.**⁵ As the pandemic puts enormous pressure on high-quality public services, people all over the world find these services chronically under-resourced after years of austerity policies. The World Health Organization (WHO) and World Bank have estimated that around half of the people in the world are not receiving all the essential healthcare services they need. Even before the Covid-19 pandemic, out-of-pocket health expenses were pushing almost 100 million people into extreme poverty each year.⁶ These factors have all contributed to the vulnerabilities that are making the impacts of the virus so challenging.

Lacking the monetary, fiscal and administrative capacity to respond to this crisis, the consequences of a combined health pandemic and a global recession will be catastrophic for many developing countries and will undermine their progress towards the SDGs. The IMF and World Bank have highlighted that the African continent will need an estimated US\$114 billion in 2020 to fight Covid-19,⁷ while the United Nations Conference for Trade and Development (UNCTAD) puts the 'financing gap' as a result of Covid-19 at a staggering US\$2 to US\$3 trillion over the next two years.⁸ In this context, more and better ODA will play a key role.

As responses by multilateral organisations such as the WHO, World Bank and IMF are widely discussed, these briefing papers aim to fill a gap by providing an initial assessment of the response of bilateral donors to the Covid-19 crisis.

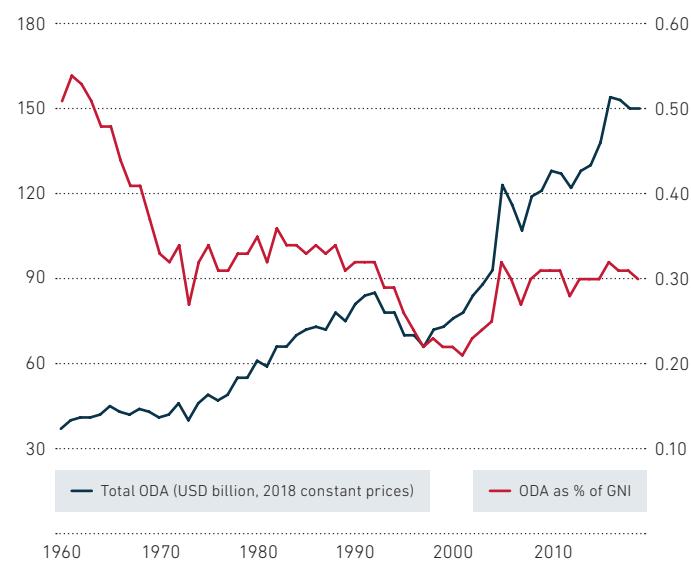
In the second part of this briefing, we discuss how these responses are exacerbating a number of key trends that risk undermining the effectiveness of development finance and ODA in particular. In the final part, we offer a few key recommendations for donors to make sure ODA is fit for the challenge presented by the current crisis.

2. Official Development Assistance: state of play

Collectively, DAC members are still falling short by more than US\$200 billion in terms of meeting their ODA commitments. While domestic public finance is by far the largest development finance resource available to developing countries, the 2030 Agenda for Sustainable Development will require more and better ODA.⁹ Figures collected by the DAC, which includes most of the developed world's donors, reveal that donors are spending less than half of what they committed to in 1970 when they agreed on a 0.7 percent of Gross National Income (GNI) spending target.

In 2019, DAC members collectively spent only 0.3 percent of GNI as ODA, with only five members meeting or exceeding the target (United Kingdom, Sweden, Denmark, Luxembourg and Norway).¹⁰ Several G7 members spent less than half of the agreed target: 0.29% for Japan, 0.27% for Canada, 0.24% for Italy and 0.16% for the US.

Figure 1: Total ODA and ODA as percentage of GNI



Source: OECD DAC1 and DAC2a, data retrieved 18 May 2020

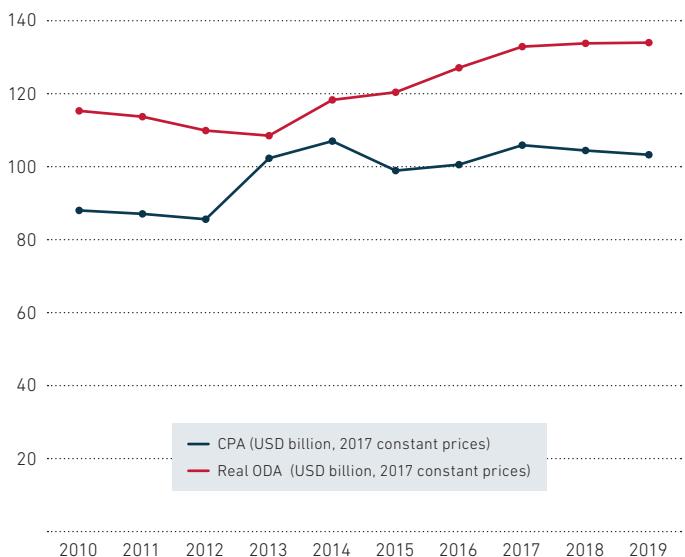
After decreasing in 2017 and 2018, ODA has remained essentially flat. In 2019, ODA in real terms and absolute figures increased by 1.4 percent compared to 2018.¹¹ Under the previous cash-flow methodology, however, ODA increased by only 0.1 percent in 2019 after a 4.3 percent decrease in 2018. One important caveat of these figures is that they do not cover additional development cooperation resources provided by non-DAC members, particularly south-south cooperation. Twenty non-DAC countries that report to the OECD spent on average US\$15.2 billion in development assistance between 2015 and 2017.¹²

Resources directly available to developing countries are seeing a downward trend. The OECD-DAC definition of ODA allows a significant portion of ODA to be spent in the donor country itself, meaning that the headline ODA figure is not the most relevant statistic when trying to measure resources from international development cooperation that are actually available to developing countries. In recent years, in-donor refugee costs explain a significant factor in the variations in ODA and amount for 6.7 percent of total ODA in 2019.

Efforts to measure the amount of ODA that is available to developing countries result in smaller figures and show that diversion of ODA to in-donor costs may have had a significant impact. Country Programmable Aid (CPA), a subset of ODA designed by the DAC as a 'closer proxy of aid that goes to partner countries than the concept of ODA',¹³ removes from ODA items that are unpredictable by nature, entail no cross-border flows, do not form part of cooperation agreements between governments, or are not country programmable by the donor.

CPA shows a downward trend over recent years indicating that less resources are directly available to developing countries. Real ODA – a measure favoured by civil society organisations (CSOs) – excluding in-donor refugee costs, imputed student costs, interest repayments on loans and debt cancellation, shows a minor increase over the past few years – primarily as a consequence of a decline in the number of asylum seekers and recognised refugees in Europe.

Figure 2: Country Programmable Aid and Real Aid



Source: Data on CPA retrieved from <https://stats.oecd.org/Index.aspx?DataSetCode=CPA>, 18 May 2020; Real ODA courtesy of Aidwatch Canada

Double counting remains a significant issue in ODA reporting.

When donors restructure bilateral debts – for example, by cancelling or rescheduling them – the amount cancelled can be reported as ODA in the year of restructuring.¹⁴ In practice, this has meant that commitments to cancel debt, such as the heavily indebted poor countries (HIPC) initiative, are met through ODA allocations. In 2006, for example, debt relief accounted for over 18 percent of total ODA. As major debt restructuring operations have not taken place in recent years, double counting with climate finance has a larger impact on ODA estimates. Oxfam has estimated that public climate finance amounted to 21 percent of total ODA in 2015–16 and cannot be regarded as 'new and additional'.¹⁵

ODA is becoming less concessional. Concessionality is fundamental to ODA, as it reflects the principle that ODA should be offered on terms that reflect a financial effort on the part of the donor, not on market terms. For developing countries, and especially Least Developed Countries (LDCs), concessionality is important as it makes the difference between getting additional resources to finance development and increasing unsustainable debt burdens that threaten to impoverish them even more.

Over the past few years, the level of concessionality has gradually decreased for developing countries in general and for LDCs in particular. In a recent report, UNCTAD has found that the increase in ODA gross disbursements to LDCs since 2011 is chiefly due to increased ODA loans, whereas grants have remained essentially stagnant, or have even declined.¹⁶ Despite their greater need for concessional resources, growth in ODA to LDCs compares unfavourably to levels of growth in other middle-income countries.

Increased use of blended finance and Private Sector Instruments is not guided by evidence demonstrating its effectiveness. While blended finance has grown rapidly, there is little evidence of its development impact. Most blended finance currently goes to middle-income countries, motivated by the size and ease of transactions, with only a small portion going to LDCs. Sectoral allocation is heavily skewed towards productive sectors such as infrastructure, telecommunications and energy. The DAC is still discussing how public support for the private sector should be included in ODA, while interim reporting indicates that donors spent US\$4.6 billion of gross ODA through Private Sector Instruments (loans, equity and guarantees directly to the private sector).¹⁷ While this appears to be a limited amount, many donors are signalling they will be scaling up spending through this modality, which may have considerable impacts on concessionality levels, allocation patterns and effectiveness.¹⁸

Donors are failing to make substantive progress on their commitments to increase the effectiveness of ODA. The Global Partnership for Effective Development Cooperation (GPEDC) – a multi-stakeholder platform including donor countries, developing countries and CSOs – produces regular assessments of progress on the four development effectiveness principles. In its latest progress report, published in 2019, the GPEDC flagged significant lack of progress in key areas such as alignment with partner country priorities, predictability of investments, country ownership and aid tying.¹⁹ This lack of progress runs parallel with a lack of political momentum and available resources to advance this crucial agenda, although the DAC recently decided to open a workstream on the issue.

3. Donor responses to Covid-19: an early assessment

While the pandemic risks impacting the most vulnerable in developing countries especially hard and undermining much of the progress made over the past decade, OECD countries are being strongly affected as well. Providers of ODA are seeing unprecedented domestic demands on public finance in coping with the pandemic, and these demands may even increase further if efforts to contain the pandemic prove to be ineffective. At the same time, political leaders have called for solidarity in battling the pandemic²⁰ while the UN's Secretary-General has argued that 'only a global victory can end this pandemic, not just a temporary rich countries' win'.²¹

3.1 Overview of commitments of bilateral donors in response to Covid-19

Mid-May monetary and fiscal stimulus packages announced by G20 countries amounted to 18 per cent of their combined Gross Domestic Product (GDP).²² In the EU, governments have announced and started to implement large packages of fiscal measures to contain the economic fallout with European Union (EU) state aid and fiscal rules being suspended. Estimates of the size of direct fiscal measures range between 10 per cent of GDP in Member States with robust public finances such as Germany and 0.4 percent of GDP in EU-13 countries such as Hungary.²³ The impact of these measures for long-term fiscal deficits in these countries, and for future policy space, is unclear and difficult to predict, particularly given the potential for future waves of coronavirus infections.

Multilateral organisations (including International Financial Institutions and regional development banks), bilateral donors and private foundations are responding to the pandemic. The Overseas Development Institute has collected data on the response of multilateral organisations and bilateral donors to the pandemic. On 30 April 2020, the response of DAC donors – where data is available – totalled over US\$22 billion, covering areas such as balance of payments and macroeconomic support, trade support and assistance to the private sector, as well as support to social and health sectors.²⁴

Although not all of these resources may qualify as ODA, this amount represents roughly 20 percent of total bilateral ODA in 2019, but is also far off from the scale of the efforts that are needed and called for by developing countries and the international community more broadly. Table 1 presents a top-line overview of initial commitments of major DAC donors in response to the Covid-19 crisis.

Table 1: an overview of initial commitments of major DAC donors in response to the pandemic

Donor	Response	Date
EU ²⁵	€16 billion of which €10.4 billion from European Commission (€5 billion from DG DEVCO) and €5 billion from European Investment Bank.	8 April
France ²⁶	€1.2 billion for 'Covid-19 Health in Common Initiative' targeting 19 priority countries of French development cooperation. €1 billion will be delivered as loans, €150 million as grants prioritising epidemiological surveillance networks, national Covid-19 response plans in African countries, support to French actors in the response to Covid-19 (non-governmental organisations (NGOs), foundations, networks, research bodies, etc.) and budget support for the reinforcement of healthcare systems.	21 April
Germany ²⁷	€1.15 billion for 'Emergency Covid-19 Support Program', which consists of 'redirected funding' within the existing budget prioritising health and pandemic control, food security and 'basic food services', stabilisation of fragile regions, social protection, support to private sector in key sectors such as textiles and tourism, government liquidity and international cooperation. The breakdown between grant-based and loan instruments is unclear grants.	23 April
Japan	\$US769 million support to IMF, WBG and UN. Japan International Cooperation Agency (JICA) continues to sign large-scale loan agreement with Covid-19 focus. ²⁸	NA
United Kingdom ²⁹	£744 million support through the Department for International Development (DFID), of which £150 million to Catastrophe Containment Relief Trust, £344 million for development of vaccines, treatments and test kits, £200 million to back UK charities and international organisations to help reduce mass infections in developing countries.	12 April
US ³⁰	Currently, over \$1 billion to combat Covid-19. Little information available on priorities, instruments, modalities and beneficiaries of support.	NA

Furthermore, it remains difficult to monitor to what extent these response packages contain new and additional resources. In the case of the EU, its initial €15.6 billion 'Global EU response to COVID-19' – including a €5.2 billion commitment from the European Investment Bank supported by guarantees from the EU budget package contains no additional money and is mainly the result of shifting and refocusing existing resources towards Covid-19 responses. As many donor countries are still operating within existing budgets, a large share of resources for the Covid-19 response comes from unearmarked funds or retooling existing programmes and projects.

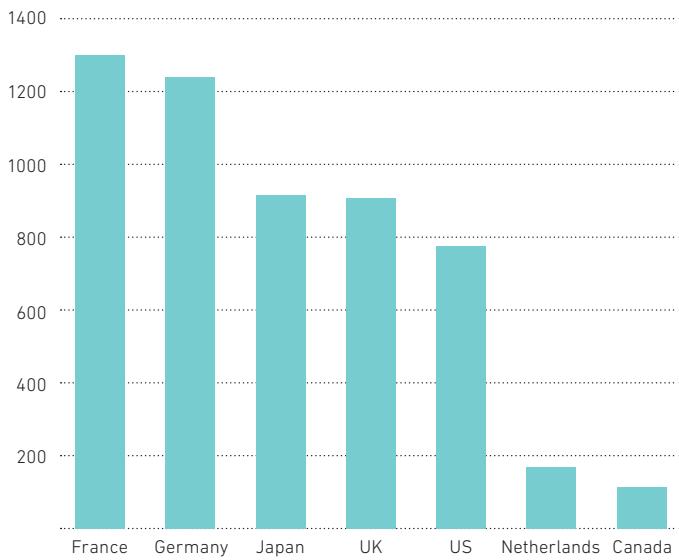
Box 1: Covid-19 and the 'Next Generation EU'

On 28 May 2020, the European Commission proposed topping up the next budget for international cooperation with an additional €15.5 billion for the 2021-2027 period as part of its 'Next Generation EU' stimulus package. While the €109 billion for external action originally proposed by the Commission had been watered down over subsequent negotiation rounds since 2018, the new total of €118 billion is an important signal from the Commission that the EU is not running away from its global responsibility.

Of the €15.5 billion top-up, €10.5 billion would go into the novel single instrument for external action (Neighbourhood, Development and International Cooperation Instrument) while €1 billion of that amount would be frontloaded to be committed in 2020 before the next EU budget starts.

The Commission is proposing to use the full amount to boost the 'External Action Guarantee', a budgetary guarantee covering sovereign and commercial risks, which would significantly increase the scope of the EU's support through 'blended' modalities at the expense of other modalities such as grants and budget support with a more solid track-record in terms of effectiveness.

It remains to be seen, however, if this proposal will survive deliberations between Member States and the Parliament and which modalities will apply to any additional EU aid spending.

Figure 3: Covid-19 Global Response (US\$ million)

Source: ODI estimates, April 2020 (https://set.odi.org/wp-content/uploads/2020/05/Donor-responses_as-of-30April-2020.pdf, retrieved 18 May 2020)

The assessment of donor responses above does not take into account additional pledges made by DAC and non-DAC members during the 'Coronavirus Global Response International Pledging Event' hosted by the European Commission and its partners on 11 May.³¹ On 22 May, €9.8 billion had been raised, according to the Commission,³² with the largest single contributions being made by the European Commission itself (€1.4 billion), Japan (€762 million), Canada (€551 million), Germany (€525 million), France (€510 million)³³ and the UK (€441 million).³⁴ The United States did not take part in the event.

The €7.5 billion target was based on an assessment by the Global Preparedness Monitoring Board – a panel of senior officials from UN agencies, executives of philanthropic foundations, government officials and health experts hosted by the WHO³⁵ – of the costs to develop safe vaccines, tests and therapeutic products and 'make them accessible and affordable in an equitable way for everyone around the world'.

The pledged resources should be supporting three partnerships:

- for vaccine deployment co-convened by the Coalition for Epidemic Preparedness Innovations (CEPI) and the vaccine alliance Gavi,
- for therapeutics co-convened by the COVID-19 Therapeutics Accelerator (a new joint venture by the Bill & Melinda Gates Foundation and the Wellcome Trust) and Unitaid and
- for diagnostics co-convened by the Foundation for Innovative New Diagnostics (FIND) and the Global Fund.

Many participants stress the need to ensure equitable access to therapeutics and vaccines, but no mechanism has been agreed upon to guarantee that. Table 2 looks at the details published by main contributors. In some cases – including the EU, Japan, UK and Canada – it is clear that pledged resources have already been announced previously or it is unclear whether these resources are 'new and additional' or re-targeting already approved resources.

3.2 Is ODA 'recession proof'?

In response to the pandemic, DAC members adopted a joint statement to 'strive to protect aid budgets'.³⁶ Notwithstanding this weak commitment, the OECD's Secretary General seemed confident that donors would not backtrack on their commitments as a consequence of the crisis as 'ODA has proved to be recession-proof in the past, including during the 2008 financial crisis'.³⁷ Development Initiatives projected, however, that even if donors maintained spending at the current 0.3 percent of GNI level, ODA could fall as much as \$US14 billion in 2020. A longer coronavirus outbreak combined with a minor drop in aid spending of 0.03 percentage points of ODA to GNI could decrease available ODA resources by \$US25 billion.³⁸

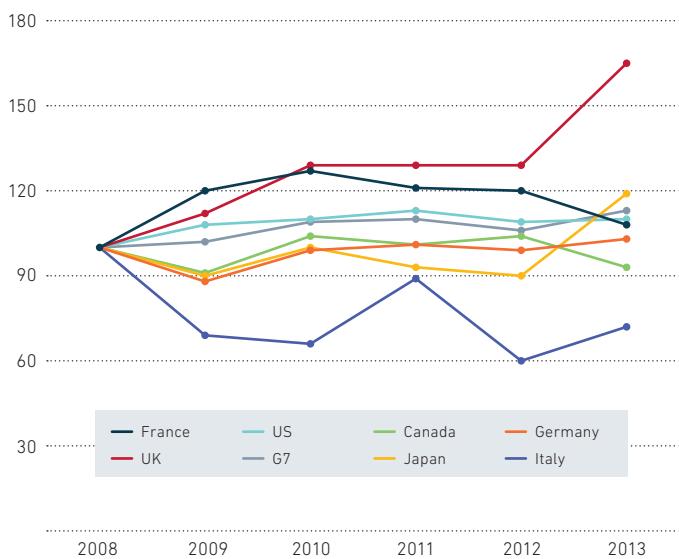
Assessing spending patterns after the Great Financial Crisis is useful to inform expectations about ODA spending in the context of the current crisis. After 2008, aggregate ODA levels remained relatively stable and even increased before dropping for two consecutive years (1 percent in real terms in 2011 and 4 percent in 2012). This aggregate trend, however, conceals very different realities in different donor countries. Figure 4 shows that the net effect at aggregate level is muted because effects of the crisis do not occur simultaneously with various donors. A second important observation is that the effects of the crisis come with a considerable lag. ODA spending in DAC countries that were hit particularly hard by the financial crisis – such as Spain, Italy and Ireland, presented in Figure 5 – was reduced most substantively only after 2011. The reason for this is that cuts in aid budgets are never straightforward as donors plan spending over multi-annual cycles.

An in-depth analysis of the process in Canada demonstrates how budget cuts are spread over a number of years through subsequent phases of 'preserving' and 'freezing' budgets before they are eventually cut.³⁹ While the immediate donor response to Covid-19 may appear adaptive and 'expansionary', it is very likely that the financial impacts on donor economies will be felt long after the Covid-19 crisis has subsided.

Table 2: contributions of major donors to Global Coronavirus Response

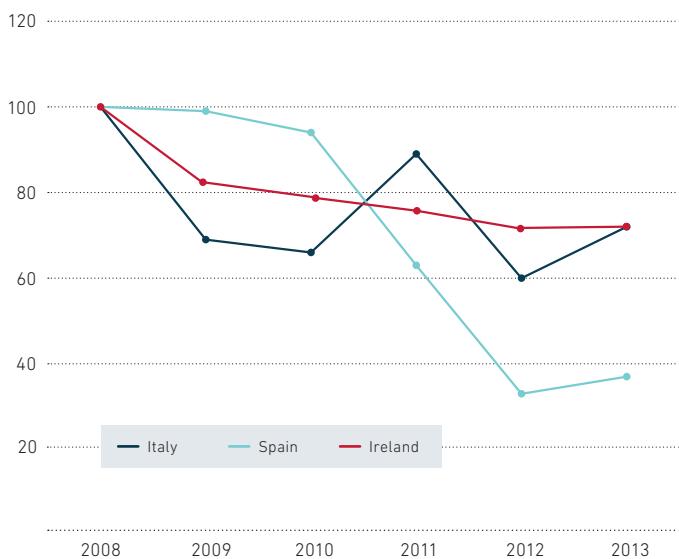
Donor	Response
EU ⁴⁰	"European Commission commits €1 billion in grants and €400 million in guarantees on loans through re-prioritisation of Horizon 2020 (€1 billion), RescEU (€80 million), the Emergency Support Instrument (€150 million) and external instruments (€170 million). €100 million will be donated to CEPI and €158 million to the World Health Organization."
Japan ⁴¹	"Japan will invest approximately US\$834 million in global efforts, focusing on the development and access to therapeutic drugs and vaccines." "In particular, Prime Minister Abe announced that approximately US\$234 million in a special pledge will be allocated to GAVI, the Vaccine Alliance, and CEPI." "Prime Minister Abe announced that Japan is giving supplies of the promising medicine Avigan, developed by FUJIFILM Toyama Chemical, to vulnerable countries. Japan is already in the process of distributing this medicine to more than 40 countries."
France ⁴²	"France [...] stumping up €500 million: to support WHO, which the global community needs to address the emergency, by cementing its key role in terms of alerts, detection and coordination; to ramp up the pace of research and development on a vaccine that must be accessible to all, in partnership with CEPI and GAVI; to conduct essential work necessary for ensuring fair access to resources to eliminate Covid-19, particularly as regards patents, as UNITAID is doing; to consolidate support for the healthcare systems in the most vulnerable countries, particularly in conjunction with the Global Fund." "These multilateral efforts complement the €1.2bn Covid-19 – Health in Common bilateral response initiative spearheaded by the French Development Agency (AFD)..."
Canada ⁴³	"The Prime Minister highlighted that, to date, the Government of Canada has announced investments of over \$850 million (CAD) that support this fundraising target. This includes funding to: <ul style="list-style-type: none">• mobilise Canadian researchers' and life sciences companies' coronavirus research and development of medical countermeasures;• support accelerated vaccine development, including through the Coalition for Epidemic Preparedness Innovations and other partners;• find a safe and effective treatment for COVID-19 through the World Health Organization (WHO) Solidarity Trial;• coordinate a COVID-19 viral and host genome sequencing effort across Canada;• help provide COVID-19 diagnostic support to more than 20 partner countries; and• create strategies to tackle misinformation, stigma, and fear."
UK ⁴⁴	"The UK has so far provided £744 million of UK aid for the global response to coronavirus. Today's pledge towards the \$8bn target is made up of the UK's previously announced £388 million support for new vaccines, tests and treatments: <ul style="list-style-type: none">• £250 million to the Coalition for Epidemic Preparedness Innovations, the biggest contribution of any country, to this fund to research a coronavirus vaccine.• £40 million to support the Global Therapeutics Accelerator, a fund for the rapid development of coronavirus treatments.• £23 million to support Foundation for Innovative New Diagnostics to develop rapid tests for the virus to help identify and slow its spread.• £75m for the World Health Organization's critical health systems response. The UK has also pledged the equivalent of £330 million a year over the next five years to Gavi, the Vaccine Alliance."

Figure 4: ODA spending in G7 countries after the financial crisis 2007-2008 (2008=100)



Source: Author's calculations based on OECD DAC 1
(data retrieved on 19 May 2020, all amounts in 2018 constant prices)

Figure 5: ODA spending of selected donors after the financial crisis (2008=100)



Source: Author's calculations based on OECD DAC 1
(data retrieved 19 May 2020, all amounts in 2018 constant prices)

4. Covid-19: a game-changer for ODA quality

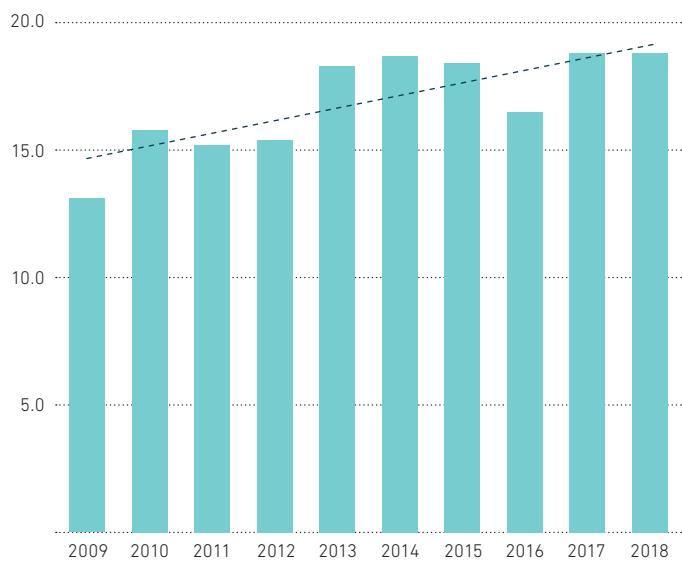
This part of the briefing looks at a number of key trends in the quality of aid and how these trends may be impacted by the current crisis. This is not an exhaustive overview and focuses primarily on issues related to aid architecture, aid modalities and financial terms. Broader geographic and sectoral allocation issues are not the main focus of this section.

4.1 Need for highly concessional resources

As the need for additional fiscal space to tackle Covid-19 and its economic fall-out is increasing, the capacity of developing countries – and certainly those countries most in need – to absorb additional lending is decreasing.⁶⁴ 64 countries spent more money on debt service payments than on health services in 2019.⁶⁵ Currently, development finance is characterised by declining levels of concessionality (a measure of the ‘softness’ of a credit reflecting the benefit to the borrower compared to a loan at the market rate).⁶⁶

Many developing countries, and especially LDCs, have been forced to resort to debt financing. In 2019, 34 countries were at high risk of debt distress or were already in default.⁶⁷ In this context, loans as a share of total ODA disbursements to developing countries have been increasing over the past decade (see Figure 6). This increase in the relative weight of loans in ODA disbursements appears even more prominent in the case of LDCs. In LDCs, loans as a share of ODA increased by more than 10 percentage points since 2011, surpassing 25 percent in 2017.⁶⁸

Figure 6: Loans as a percentage of total bilateral ODA



Source: Author's calculations, based on OECD DAC2a
(data retrieved 19 May 2020, all amounts in 2019 constant prices)

This trend is cause for concern, even more so as recent policy responses by the World Bank and IMF – but also of major bilateral donors such as Japan and France – focus heavily on additional lending to developing countries. In this context, there is a strong need for donors to prioritise grant-based financing as the default option, especially to LDCs, while also re-assessing reporting directives to remove incentives that favour loans over grants.

4.2 Increased caution for blended finance and private sector instruments

Notwithstanding the discussions on the effectiveness of blended finance, most donors are planning on expanding their use of Private Sector Instruments.⁴⁹ As supply-side factors seem to be driving the agenda on blended finance, it is likely that donors will keep pushing the narrative of private finance as the most important part of development finance in the foreseeable future. In the medium term, we could expect donor priorities to shift from the global health crisis to supporting economic recovery and reconstruction. Together with the interest from investors in advanced economies with surplus liquidity, this will give additional traction to the agenda of using ODA to mobilise private sources of finance.

As the economic fall-out of Covid-19 is being transmitted to balance sheets of multilateral and bilateral Development Finance Institutions (DFIs) through their client companies, pressure on their shareholders – in most cases donor country governments – to step in is increasing. Advocates of DFIs have been calling on shareholders 'for a more robust response to the crisis' in the form of capital injections, topping-up of risk-sharing schemes and additional funds for technical assistance.⁵⁰ If donors respond to these calls, this will increase the share of Private Sector Instruments (PSI) in total ODA.. Adding to this pressure on ODA budgets are potential defaults of clients triggering guarantees that donors will have to pay out.

In response to the crisis, advocates of the key role for DFIs are calling for a two-pronged strategy. First, DFIs need to respond to the immediate need for liquidity of existing clients to protect their investments and preserve development impact. Second, on the mid- to long-term recovery response DFIs may be the only source of long-term finance available, which requires the upscaling of DFI resources.⁵¹ However, two key concerns cannot be overlooked when assessing the role of DFIs in driving economic reconstruction:

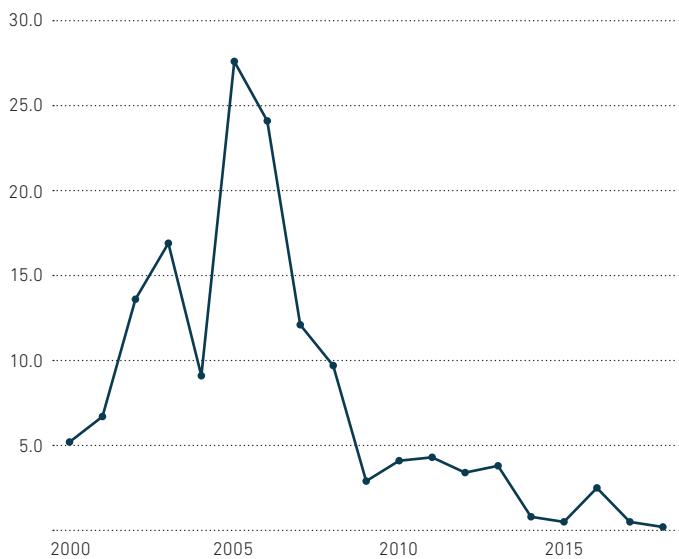
- **Lack of scale:** recent evidence shows that high expectations of the leverage effects are unrealistic and DFIs operations are playing only a marginal role in scaling up investment in many developing countries.⁵² While DFIs can play a role in saving existing businesses from immediately closing down, transforming economies in many developing countries to help them 'bounce back better' may require other policy interventions.

- **Business as usual:** Blended finance projects tend to be heavily concentrated in middle-income countries and specific sectors, while many DFIs continue to have a poor track record in delivering human rights-centred development, transparency and accountability. The involvement of DFIs in donor responses to the current crisis risks exacerbating the concentration of blended finance and ODA in emerging economies and productive sectors on the one hand, while also driving investors to sectors in the heart of Covid-19 responses, e.g. support to health sector and small-scale agriculture still uncommon today.

These concerns, combined with the need for multilateral, regional and national development banks to provide long-term, sustainable, predictable and counter-cyclical funding in support of nationally-driven development strategies, highlights the importance of an urgent debate on the development finance architecture required to 'bounce back better'. This debate should centre on ensuring DFIs have a clear mandate that focuses solely on delivering development-focused outcomes and systems and ensures that structures are in place to align practice with development effectiveness principles.

4.3 Return of debt relief as aid modality

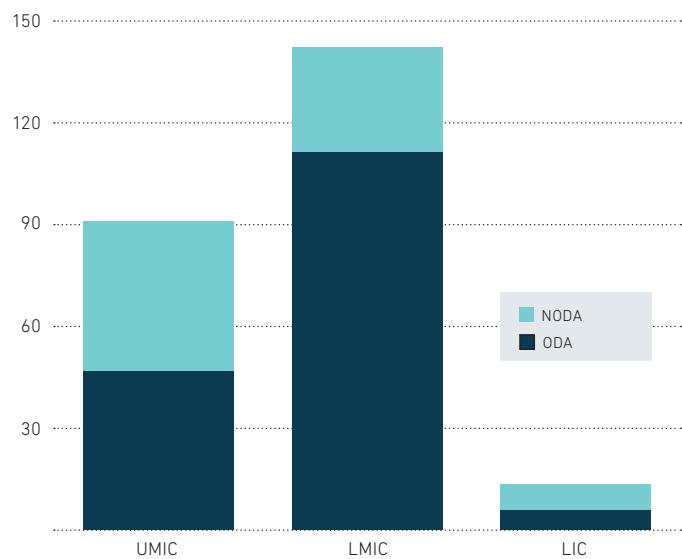
Debt relief has been decreasing as a share of total bilateral ODA since the mid-2000s when donors granted large debt relief packages as part of multilateral efforts and ad hoc agreements. In 2019, debt relief amounted to 0.2 percent of total bilateral ODA. However, debt relief is expected to return as an aid modality as calls for much-needed debt relief – beyond 'coordinated and equitable debt management efforts' – are gaining traction.

Figure 7: Debt relief as a percentage of ODA

Source: Author's calculation, based on OECD DAC2a (retrieved 19 May 2020)

On 13 April 2020, the IMF Board approved immediate debt relief to 25 countries.⁵³ The scope of this initiative is dependent on IMF shareholders' contributions to a specific facility – the Catastrophe Containment Relief Trust (CCRT), which is designed to finance debt relief granted by the IMF. Currently the CCRT can provide \$US500 million in grant-based debt relief, which is funded by contributions from the UK (\$US185 million), Japan (\$US100 million) and other donors. This request from the IMF to shareholders to compensate for its debt relief represents a potential deviation of scarce ODA resources.

On 15 April, the G20 announced an agreement to suspend public external debt service for a group of 77 developing countries to help tackle Covid-19. The G20 Debt Service Suspension Initiative (DSSI) involves the postponement of up to \$US12 billion in debt payments to official bilateral creditors until the end of 2020.⁵⁴ As the initiative does not cover multilateral and external private creditors and countries covered by this initiative are expected to pay back missed payments over a four-year window, pressure on creditors will remain to grant permanent debt forgiveness.

Figure 8: Debt held by Paris Club in 2018 (US\$ billion)⁵⁵

Source: Paris Club, 2019

Assessing the impact of additional debt relief efforts on the fiscal space of developing countries to tackle the crisis is difficult. Figure 8 shows the total amount of claims held by official bilateral creditors that are members of the Paris Club – an informal group of creditor governments – on developing countries, which total approximately \$US250 billion. While informative, this is not necessarily a good indicator of the impact of debt relief on the resources that will become available to developing countries as a result of debt relief for two main reasons.

First, the net cash flow gains from debt relief are dependent on the contractual debt service payments that will be cancelled. In turn, these debt servicing costs depend on the specific repayment terms and time schedule provided for in contracts when the debt was issued. As this information is currently not provided by creditor governments, it is very difficult to assess the net gain from debt relief.

Second, debt relief may also crowd out other potentially more effective aid modalities. We cannot just assume that debt relief will come on top of other forms of donor support, especially not in a context where debt relief can be reported as ODA and several donor governments peg their spending to a pre-determined ODA-to-GNI ratio benchmark. Based on loan repayments reported by DAC members, the OECD estimates the resources involved in the standstill agreed by the G20 between \$US1.5 and US\$3 billion while accruing mainly to just a few DAC members (France, Japan, Germany, European Union).⁵⁶

As donors are considering relief efforts beyond temporary standstills, it is important to make sure these efforts are effective in the sense that they translate into additional fiscal space to finance policies that are centred on human rights and gender equality, and on kick-starting a transition to climate resilient and sustainable economies. Assessments of earlier debt relief initiatives are most effective if they are equivalent to (sector) budget support and are complementary to other aid modalities.⁵⁷

4.4 Other issues and challenges

Aid orphans

As donors are prioritising immediate responses to the Covid-19 crisis, there is a risk this will create 'aid orphans' in other key areas and sectors. This was the case in developing countries affected by ebola, where donor resources became heavily concentrated in emergency health responses to the epidemic, while other key areas – including in basic essential non-ebola health services – were underfunded. As a means to mitigate this risk, CSOs have proposed the need to introduce a 'Covid-19 marker' that would allow the tracking of resources that are being targeted towards Covid-19 responses and can serve as an important tool to increase transparency and accountability.

ODA integrity

Since the late 1960s, ODA has been a measure of donor effort to support developing countries and has been regarded as a key tool for international accountability of providers. The integrity of this measure has long been undermined by including costs of students and refugees in donor countries, while recent efforts to 'modernise' ODA have jeopardised this measure even further.⁵⁸ Recent data has also revealed that US\$21 billion of ODA remains tied.⁵⁹ Eurodad research showed donors awarded 51 percent of the aid contracts they report to the OECD to their own domestic companies, and just 7 percent to suppliers in the poorest countries.⁶⁰

Since part of donors' response to Covid-19 is focusing on global efforts to develop vaccines, treatments, test kits and other tools to prevent the disease from spreading, there is a risk that such expenses will be included as ODA while they do not have the 'promotion of the economic development and welfare of developing countries' as their main objective. In the context of ODA modernisation as well, donors are pushing an alternative metric to provide a comprehensive picture of global, official and officially-supported resource flows to promote and support sustainable development in developing countries.

While CSOs have highlighted many problematic issues with Total Official Support for Sustainable Development, it will be key to make clear that support to global public goods cannot be confused with ODA.⁶¹ To maintain the integrity of ODA, such expenditures should not be included as ODA, while efforts undertaken by donor countries to ensure free access to such tools that are essential to combat the disease in developing countries can be considered as ODA.

A green recovery in line with the Paris Agreement

Work in the OECD over the past few years has prioritised aligning the Sustainable Development Goal Agenda 2030 with the Paris Agreement, not only looking at development cooperation but also at the lack of coherence of donors' broader international activities and at the level of the broader development finance system. As donors' priorities focus on addressing the immediate health crisis and post-Covid-19 recovery, it will be paramount to make sure these efforts are not only aligned with existing global climate, sustainable development and biodiversity goals, but are also designed to support the transition to resilient, sustainable, inclusive and climate-proof economies.

Given that 2020 is the delivery year for the first phase of the US\$100 billion global climate finance goal, developed countries' recovery plans must include a climate finance support fund, and outline how they will continue contributing to the goal at a national level between 2020 and 2025. Climate finance flows must be additional to existing aid and finance commitments and should increasingly be channelled to climate adaptation and resilience in the wake of increasing disruptions to the lives and livelihoods of those living in poverty and communities on the frontline of the climate crisis. Moreover, it is imperative to ensure that access to financial resources is improved, particularly access for regional and local authorities. Doing so will help ensure that finance reaches the most vulnerable within frontline communities, including women and particularly indigenous women.

ODA – key part of systemic responses

ODA is of course only a part of any systemic response to break the cycle of interconnected and repeated crises and to address the underlying social, environmental and economic drivers of vulnerability and inequality. CSOs that are actively engaging the multilateral Financing for Development (FFD) process have called for a 4th FFD conference in the form of an Economic Reconstruction and Systemic Reform Summit, with participation of the highest levels of government. This should aim to deliver intergovernmental agreements on key outstanding issues, including on debt resolution and international tax cooperation, and the requirements as expressed by developing countries, particularly the poorest, in adapting to a post-Covid world.⁶²

It should also consider some of the important proposals that have already been put forward by different UN actors. For example, UNCTAD has called for a US\$2.5 trillion coronavirus crisis package for developing countries.⁶³ The UN Secretary-General has also echoed the call for the establishment of a sovereign debt restructuring mechanism to strengthen debt sustainability, and detailed considerations have been elaborated in a new report from UNCTAD.⁶⁴ The DAC should support these efforts under the auspices of the UN and use this as an opportunity to raise the ambitions and profile of ODA as part of these systemic responses.

5. Conclusion

The current Covid-19 pandemic presents the world with a challenge that is unparalleled in our lifetime. While advanced economies are being hit exceptionally hard, they have substantive capacities to respond and protect lives and livelihoods. Developing countries, already in a difficult place before Covid-19, have very limited fiscal capacity to respond.

In an immediate reaction to the pandemic, 40 CSOs that are part of the DAC-CSO Reference Group working to influence DAC policies called to protect, fulfill and surpass existing aid commitments, direct aid and debt relief to those most in need and keep aid focused on critical areas, distinct and additional to humanitarian responses.⁶⁵

Based on this initial assessment of responses by DAC members, making ODA match the challenges presented by Covid-19 requires the following urgent actions by providers of ODA:

1. Scale up resources to match the challenge

- **Donors should rapidly scale up ODA to achieve levels already committed to in the past.** Given the challenges ahead merely 'striving to protect ODA budgets' signals a striking lack of ambition. Scaling up ODA to at least the level donors have already committed would add another US\$200 billion of resources that can be targeted towards the most vulnerable and affected people by the pandemic. While a significant injection, it is still falling short of the amounts called for by the UN as part of a bold and ambitious Marshall Plan, which includes 'missing' ODA that has long been promised but never delivered.⁶⁶
- **Bilateral creditors should cancel all external debt payments due in 2020 and 2021 on a permanent basis and support calls for further debt relief in the months to come.** Donors need to ensure debt relief – whether on a multilateral or bilateral basis – results in additional net resources available to developing countries to uphold human rights, finance essential public services and allow for a just transition of their economies. Debt relief should be equivalent to budget support and complementary to higher aid spending through other modalities. In order to allow stakeholders – including civil society – to assess the impacts of any future proposals, more transparency of lenders' practices is needed. As part of DAC, donors should include statistical data on bilateral credits, breakdown between concessional and non-concessional stocks and average terms granted by country.

2. Improve the quality of ODA to align with developing countries' needs in the face of the pandemic

- **Deliver ODA in the form of grants instead of loans and remove incentives from ODA accounting that favour lending over grant financing.** In this respect, the DAC needs to consider a review of the discount rates used to assess the concessionality of ODA in the form of loans.
- **Adopt a cautious approach to blended finance and ensure all finance mobilised through blending meets development effectiveness principles.** While blended finance has grown rapidly, the evidence of its development impact is less robust. ODA should be allocated first and foremost where the needs and impact are greatest.
- **Embark on an 'effectiveness agenda 2.0' including a revitalisation of the 'traditional' development effectiveness agenda while rethinking what development effectiveness means for new actors in development cooperation.** Current responses risk undermining key effectiveness principles such as ownership and transparency and accountability, while progress in this field was stalled even before Covid-19.⁶⁷
- **Maintain integrity of ODA as a measure of donor effort to support sustainable development and poverty eradication in the global south.** Covid-19 presents particular challenges to the integrity and credibility of ODA as spending on global goods benefits both donor and developing countries, while access for people in developing countries to such goods on acceptable terms is currently not guaranteed.

3. Rethink 'aid architecture' to bounce-back better

- Over recent years, global 'aid architecture' has changed considerably. Following the increased prominence of the private sector as 'development actor', increased South-South cooperation and development of new modalities and instruments of raising and delivering aid in the wake of 'finance driven globalisation', e.g. blended finance and public-private partnerships, the aid landscape is becoming more fragmented, complex and opaque.⁶⁸
- Responses to Covid-19 are expected to add to these complexities as a consequence of calls to focus on leveraging public development finance through the private sector and drastically expanding the capacity of and coordination between DFIs. However, to 'bounce back better' and enable the radical transformation needed for a truly sustainable and just economic recovery, a debate on the appropriate development architecture and financial institutions is urgently needed.

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