TRANSITION FINANCE 2019

Financing sustainable development (FSD) is a global challenge involving a fast-growing number of actors and instruments – both public and private. **Inequalities remain**: depending on their level of income and other factors, such as their size or fragility, countries gain and loose access to different sources of FSD. **The financing and achievement of the 2030 Agenda is at threat**: the most recent data on Official Development Assistance (ODA) and Foreign Direct Investment (FDI) shows that external finance flowing to countries most in need is sharply declining.

WHAT IS TRANSITION FINANCE?

The OECD/DCD work on "transition finance" analyses the availability and articulation of different sources of FSD as countries develop, with the aim of identifying an **optimal financing mix** tailored to countries' specific development needs. It aims to provide the OECD Development Assistance Committee (DAC) with recommendations on how to make best use of scarce public resources, leveraging other sources of FSD, and avoid country- or sector-specific financing gaps as countries transition. It is about **mobilising** the right actors at the right time, and **maximising** the impact of our collective efforts.

➡ We call "transition" the journey towards the achievement of sustainable development and the 2030 Agenda's Goals, and "transition finance" the financing of that journey.

WHAT IS THE OECD/DCD MANDATE ON TRANSITION FINANCE?

In response to the FSD challenge, the 2017 DAC high level meeting (HLM) Communiqué asked the OECD/DCD for assistance "to better understand the broad catalytic effect of official support and other resources by understanding the interlinkages among ODA, partner countries' domestic resources, private investment, remittances [...]", and to "continue to collaborate with other experts within the OECD and beyond in order to have a global overview and outlook on financing for development" (para 15). Since, the DAC has continuously supported the work on transition finance – on substance, financially and logistically (e.g. through the facilitation of field visits).

Progressively, co-operation across OECD was developed, e.g. with CTP to better include domestic resources mobilisation (DRM) perspectives, or with DEV to complement the Multi-Dimensional Country Reviews (MDCR).

WHAT IS THE OECD/DCD TRANSITION FINANCE ROADMAP?

The scope of the work on transition finance has expanded. A **transition finance roadmap** was prepared to provide a rigorous economic and evidence-based analysis of challenges facing the DAC and its partners. This roadmap includes the publication of (i) a methodological paper that provides a logical framework for the analysis, (ii) multiple country pilots representative of different stages of transition, geographies and country contexts, (iii) a compendium of policy conclusions and recommendations, and (iv) an interactive toolkit to be made available online. So far, the methodological paper and six pilot studies were completed:

- ✓ **Cabo Verde** (graduation from LDC category),
- ✓ **Zambia** (transition from LIC to LMIC category),
- ✓ **Uganda** (transition to UMIC category in a fragile context),

- ✓ **Lebanon** (transition in a fragile context),
- ✓ **Vietnam** (graduation from IDA), and
- ✓ **Chile** (graduation from the DAC List of ODA recipients).

As further demands from the DAC arise, more pilots will be conducted (e.g. tentatively in a Pacific SIDS, Mexico, Bangladesh, Indonesia).

TRANSITION FINANCE: MAIN POLICY RECOMMENDATIONS

The DAC has a major role to play in ensuring a smooth transition of countries and should focus on:

✓ Better anticipation and preparation of substitutions – using ODA and non-concessional flows (Other Official Flows – OOF) to support a sustainable transition finance path;

✓ Better support to countries in transition through adequate capacity building (e.g. debt management support), investment in enablers (e.g. domestic resource mobilisation, trade and investment promotion) and in channels (e.g. financial system, business environment);

✓ Better mitigation of the effects of ODA phasing-out and resilience building, as well as definition of new forms of co-operation less funding-focused.

➡ The major findings and reflections demonstrate the need to re-think and re-define the role of the DAC relative to emerging donors and to reflect on how to concretely increase and incentivise the role of the private sector in support of the SDGs.

TRANSITION FINANCE COUNTRY PILOTS: MAIN FINDINGS

Cabo Verde

An LMIC and LDC graduate (2007), Cabo Verde faces persistent structural barriers to transition due to unique vulnerabilities as a SIDS. Although development finance increased following LDC graduation, the terms and conditions have tightened. The country is engaging actors, particularly the People's Republic of China (PRC), to leverage new investment opportunities; however, it is now at high risk of debt distress.

What general lessons can be drawn for DAC members?

- ✓ Integrate sustainable development criteria beyond income: Development partners must consider integrating measures of sustainable development beyond income per capita (e.g. environmental vulnerabilities) when deciding on the allocation of resources along the development continuum.
- ✓ Promote effective transition support groups to monitor key transition milestones and provide support to renegotiate key economic policy agreements that shift following LDC graduation (e.g. preferential trade schemes, etc.).
- ✓ Ensure return on investment to repay debt: Key sectors such as infrastructure must be strengthened to attract the private sector and to ensure a return on investment to repay growing debt. Role of DAC and emerging countries (PRC) needs to be better assessed and dialogue engaged to avoid existing tensions – lack of transparency ("hidden agenda") and blame game.
- ✓ Harness the Blue Economy: Development partners can support national priorities in leveraging the vast array of resources in areas such as renewable energy that can spur additional investment opportunities and shift energy production, particularly solar and wind energy.

Zambia

Zambia is a Lower Middle-Income Country (LMIC) but also belongs to the group of Least Developed Countries (LDC). Zambia has a high reliance on one single commodity, with over 70% of exports being related to copper. 60% of the population live below the poverty line, and high levels of public debt decrease fiscal space to address these vulnerabilities.

How can the DAC support overcoming debt distress and facilitate transition towards LMIC status?

- ✓ Overcome the risk of debt distress: Access to financial markets and new finance providers creates opportunities but also risks. Develop Multilateral guidelines and best practices for sustainable lending. Provide technical assistance for debt management and negotiation. Increase support for governance reforms and effective public financial management.
- ✓ Target social vulnerabilities: Graduation from LIC should not hide that DAC providers still have an important gap to fill in targeting social sectors. Encourage the mobilisation of domestic resources and strengthen domestic systems for resilience in social sectors after eventual donor exit. Better coordinate and anticipate phasing-out of providers to avoid setbacks.
- ✓ Promote private sector development: Develop local value chains including in agriculture. Increase technical assistance related to mining sector regulation and policy-making.

Uganda

Uganda has high ambitions to transition to LMIC status by 2020 and UMIC status by 2040, driven by the expectation of future oil revenues. Uganda also faces a special development challenge as host to over a million refugees, and faces the threats of regional instability and an increasing debt burden.

How can the development community support Uganda's transition ambitions?

- ✓ Help tackle the "resource curse": Support governance reform, and increase investments in agricultural productivity and economic diversification. There is evidence that rather than fuelling Uganda's transition, high expectations regarding oil revenues are instead fuelling higher cost, riskier borrowing and diverting resources from more productive investments.
- ✓ Target vulnerabilities and the sustainability of social spending. Align and increase support for domestic resources mobilisation and alternative models of service provision (decentralised, public-private etc).
- ✓ Fully integrate refugees into economic and social planning, financing, and development partnerships. The refugee population brings economic opportunities for refugees and host communities, by better leveraging domestic and international processes such as the *Pathways to Peace* agenda.
- ✓ Develop risk financing and management capacities across the economy: such facilities do not feature prominently, yet Uganda's exposure to climate, economic, and social risks is increasing, with potential for significant development set-backs.

Lebanon

A UMIC in the MENA region, Lebanon experiences fragilities and structural deficits including among governance, infrastructure, public service delivery and overall economic development. Regional instability, the Syrian crisis and large number of refugees living in the country have compounded the country's long-standing deficits.

What general lessons can be drawn for DAC members?

- ✓ Development partners and concessional finance play a critical role in supporting the provision of Global Public Goods in developing countries, here safe migration and regional stability.
- ✓ Assisting developing countries experiencing significant external shocks can help moderate negative effects and foster a smooth transition away from experiencing fragilities, regardless of its income level. Financing

is most effective when exceeding initial short-term needs and accompanied by more long-term oriented development strategies from both donors and recipients.

- ✓ Bilateral donors and special financing facilities (e.g. the GCFF) can accommodate for countries exceeding concessional financing windows of MDBs. Development partners can strengthen the humanitarian-development nexus to ensure financing is sustainable; yet, the study also reveals a context-specific nature of the nexus depending on the local political economy.
- ✓ Resuming development partnerships with countries in response to experiencing shocks allows to address long-standing deficits and development challenges; this requires improved donor coordination and a functioning ecosystem of development assistance to ensure an adequate incentive system, conditionality and mutual accountability.

Viet Nam

After launching a series of successful reforms beginning in the late 1980's, Viet Nam has undergone an impressive transformation, which turned the country from a centrally planned to a market-oriented economy and from a low-income to a lower middle-income country. However, to move up further along the development continuum, Viet Nam has to remove imbalances between a burgeoning FDI sector and a relatively weak domestic private sector, while ensuring that economic growth is inclusive and environmentally sustainable.

What lessons can be drawn for DAC members?

- ✓ Continue critical infrastructure investments to enhance connectivity and green growth in Viet Nam. Debt management needs to be improved to handle a move of traditional development partners away from concessionality, and support local development needs.
- ✓ Strengthen enabling environment for the domestic private sector: Support financial sector development, including through capitalization of industries. Facilitate local value addition through better linkages between SMEs and multinationals, increased standards and other trade facilitation efforts.
- ✓ Shift from development towards economic diplomacy: New-generation FTAs (CPTTP and EU FTA) have potential to raise social and environmental standards. However, effective enforcement is a big challenge. DAC members can provide support to build capacities for better compliance with new standards and build resilience of inclusive and environmentally sustainable growth as private sector takes financing lead.

Chile

Having exceeded the high-income country threshold for three consecutive years, end 2017 Chile graduated from the DAC list of ODA recipients.

How can the DAC help manage ODA graduation, learn from Chile's experience and help developing countries avoid the middle-income trap?

- ✓ Domestic government responsibilities should occupy a central place when facing MIC status. Peer to peer learning and DAC members' exchanges of experiences can be highly useful for countries to better manage ODA graduation. A new space for dialogue and data gathering should increase transparency of development cooperation beyond ODA. Setbacks need to be avoided ensuring proper substitution of ODA with domestic or other types of foreign financing.
- ✓ Quality of funding should progressively move to include more technical co-operation, focusing in particular on qualitative and sustainable investments as a core feature of such co-operation.
- ✓ Incentives could be put in place to encourage private savings to be invested in sustainable/innovative projects to tackle major challenges (inequalities, low productivity and low R&D investments, diversification of the economy).