



Policy Brief

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Overview

Policy coherence implies that donors in pursuing domestic policy objectives should avoid adversely affecting the development prospects of poor countries. To achieve policy coherence donors and multilateral institutions need to ensure security and political stability; foresee the impacts of macroeconomic policies on developing-country growth; increase both market access and capacity-building for developing economies; support governance structures that help to maintain financial stability; and improve aid effectiveness in developing countries. In this regard, the completion of pending international commitments, such as the Doha Development Round, is fundamental. The monitoring and evaluation process for policy coherence also remains a challenge.

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Enhancing Development through Policy Coherence

POLICY COHERENCE IS THE SYSTEMATIC PROMOTION OF measures across government departments and agencies. The approach should help in implementing consistent policies to achieve agreed objectives. From a development standpoint, policy coherence implies that developed countries, in pursuing domestic policy objectives in areas such as trade, agriculture, the environment or migration, should, at a minimum, avoid consequences which could adversely affect the development prospects of poor countries. This brief elucidates issues related to the coherence of development policy and the implications for development cooperation. The brief also examines the impact of policies implemented by developed countries on the autonomous policy space of developing countries.

Coherence of Development Policy

Development cooperation policy

Development cooperation policy aims at shaping the principles and rules of development cooperation, and at helping to identify priority areas and modalities for support. The United Nations Financing for Development Conference, which led to the Monterrey Consensus in 2002 and the follow up Review on Financing for Development in Doha in 2008, identifies key issues for effective development cooperation. These include enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development as one of the leading actions. The agreements have advanced actions, recommendations and commitments to be undertaken by developing and developed countries on domestic governance and inter-ministerial coordination. Also, the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD) emphasizes the importance of ensuring that the relevant policies are consistent with commonly agreed-upon development objectives. Similarly, the Paris Declaration (2005) puts forward an agenda for improving aid effectiveness including the harmonization of donor policy and alignment with national policy.

The above-mentioned agenda advocates for mutual commitment to achieve enhanced development assistance effectiveness by promoting improvements in: i) *ownership*, whereby developing countries decide their own strategies for poverty reduction and improve their institutions; ii) *alignment* of donors behind these

objectives and use of local systems; iii) *harmonization*, which entails better coordination, simplification of procedures and sharing information between the donor countries to improve accountability; and iv) *mutual accountability* on the part of the donors and developing partners alike for development results. According to this framework, aggregate resources need to be available to developing countries from the donors in terms of contributions to aid programmes, bilateral and multilateral, and donors should commit to improving their development assistance policies.

Subsequently, the Accra Agenda for Action (2008) aimed to accelerate progress on the commitments drawn up in the Paris Declaration. This new agenda provided further guidelines on the architecture and governance of development policy, specifically on how aid is given and spent. The areas of action put forward are: i) *predictability*: 3–5 year advanced information to be provided by the donors on their aid plans to partner countries; ii) *country systems*: partner country systems, rather than

donor systems, to be used to deliver aid; iii) *conditionality*: donors to focus on the development objectives of the recipient country rather than on prescriptive conditions regarding the use of aid; and iv) *untying*: donors to remove restrictions that prevent developing countries from using their own criteria for the allocation of aid, and from buying the necessary goods and services from the source(s) of their choice.

The application of the Paris Declaration remains uncertain. According to a comprehensive OECD survey,¹ there has been some progress but the Paris targets have not been met by their target date which was the current year (2010), particularly the principles of harmonization and alignment. Donor coordination has also become difficult, due to the entry of new donors and new programmes (reflecting the enlargement of the European Union and the increasing importance of South-South and triangular cooperation).

Aid Modalities

Aid remains an important source of foreign financing for development for most developing countries particularly the least developed countries (see Figures 1 and 2). Official development assistance (ODA) plays a role in raising the levels of social investment, promoting the emergence of a strong private sector, as well as financial systems and trade facilitation in poorer countries. Development assistance is also part of the efforts to reduce both bilateral and multilateral debt in poor countries. Development cooperation programmes can have direct impacts on poverty and social challenges in poorer countries. Moreover, aid has a positive and robust causal effect on growth over the long run.² Therefore, aid remains an important tool for enhancing the development prospects of poor nations.

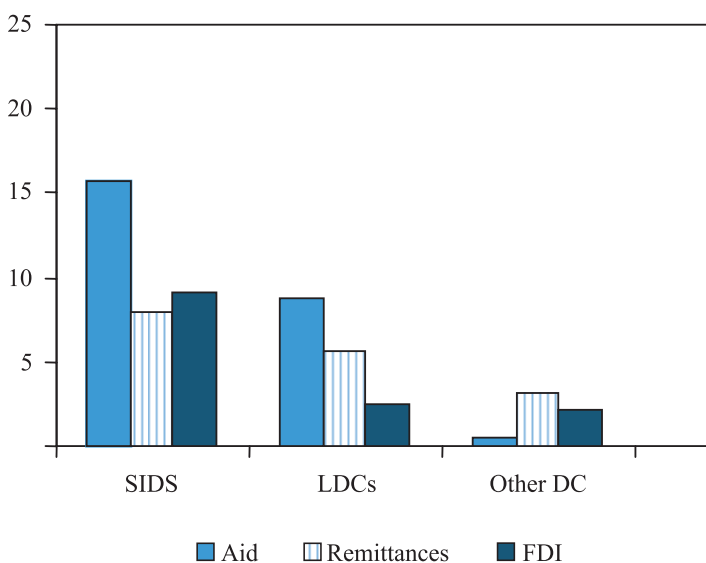


Figure 1: Capital Flows to Developing Countries, 1980–2006 (period average)
Source: Compiled by the author based on World Bank (2009) *World Development Indicators*, online.
Note: SIDS = small island developing states, LDCs = least developed countries, Other DC = other developing countries, FDI = foreign direct investment

But aid modalities and the development assistance architecture are embedded with fundamental weaknesses. For instance, fragmentation, misplaced priorities, conditionalities and the unpredictability of aid flows on the supply side (i.e. donors), as well as ownership, aid dependence, moral hazard and absorptive capacity on the demand side (i.e. recipients) are latent issues.² This is detrimental for building confidence in development cooperation and for improving aid effectiveness. These issues also have important implications for the type of aid and modalities that would ensure the achievement of the Millennium Development Goals (MDGs).

The modality of aid has evolved from project-based aid in the 1960s–1980s, to policy-based support (which founded the conditionality-tied aid in the 1990s) and more recently to budget support, which addresses the major constraints of ownership and governance. The emergence of new aid approaches and the related institutional frameworks are a response to the weaknesses of the typical aid modalities, i.e. project-based aid, debt relief and balance-of-payments support, and assistance-based structural adjustment. Currently, general budget support (GBS), sector budget support (SBS) and pooling-fund arrangements under the Sector-Wide Approach (SWAp), together with the introduction of the Poverty Reduction Strategy Paper (PRSP) are major instruments, particularly in Africa. But, the relative merits of different aid modalities have been subject to significant debate with different sides arguing for specific aid modalities. Furthermore, contextual differences matter for the choice of aid modalities, which in turn can affect aid effectiveness. That is, the prerequisite of a successful aid programme is that the elements of a desirable development

strategy are matched to an appropriate aid strategy and supported by well-designed modalities and effective implementation.³

Implications for Development Policy

Despite the various initiatives of the development community, the framework of the development cooperation system remains unbalanced. Efforts concerning policy coherence for development often aim at improving the management and evaluation of the aid agency, programmes and projects. Issues of consistency involving policies, countries and agencies have been neglected. An example of incoherence between aid and non-aid development cooperation is the impact of developed partners' agricultural policies on developing countries' food security objectives—one of the MDGs. Within the Doha Development Agenda, there appears an objective on the phasing out of export refunds, reduction of market support and other distorting subsidies. Development policy coherence could be more effective if efforts in development policy and cooperation were to extend beyond aid. That is why institutional coordinating mechanisms are indispensable for improving policy coherence.

Policy Coherence from Various Perspectives

Donors' Perspectives

A key factor contributing to the improvement of coherence between donors has been the endorsement of the Millennium declaration. Specifically, the framework for overseeing the performance of developing countries—i.e., the PRSP system—represents a collective effort to improve monitoring and transparency, and is the donors' main tool for assessing the recipients' compliance. However, the PRSP initiative places greater emphasis and weight

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on the assessment of developing countries' performance than on the impact developed country policies may have on the probability of achieving the desired outcome.

effort is in place to monitor the improvement of policies in developed countries. A key area of incoherence also exists between agricultural policy and development policy; agricultural

“Policy coherence could be more effective if efforts in development policy and cooperation were to extend beyond aid”

Another point of note is that the framework makes greater demand on developing than developed countries; only MDG 8 (i.e., “Develop a global partnership for development”) addresses the responsibilities of developed countries, and most of the agreed MDG indicators (35 out of 48) directly concern developing countries. Even here, the responsibility of the developed country is less.⁴ Thus, resources have been allocated to monitor the progress of policies and programmes in developing countries, but no similar

subsidies continue to hinder the ability of developing countries to export their agricultural products. Although development policy coherence has legal implications, substantial ambiguity remains in the current application by advanced countries.⁵ Despite the persisting flaws in donor approaches, they advocate that developing countries still need to take more responsibility for their own development, through more effective design and implementation of development policy, and through national resource mobilization.

Developing Countries' Perspectives on Policy Effectiveness

Channels of incoherence cited frequently by aid recipients with regard to development policy and cooperation between donors and recipients concern trade, international remittances, foreign direct investment (FDI) and external debt. The main challenge is the lack of an institutional framework for a more extensive and inclusive relationship between the two parties. Aid recipients maintain that donor effectiveness requires deep commitment, responsiveness and support for recipient government policy.⁶ Although there is a general consensus among recipients and donors on what makes aid effective, some divergence persists. Recipients' own views on the most effective multilateral donors suggest that the

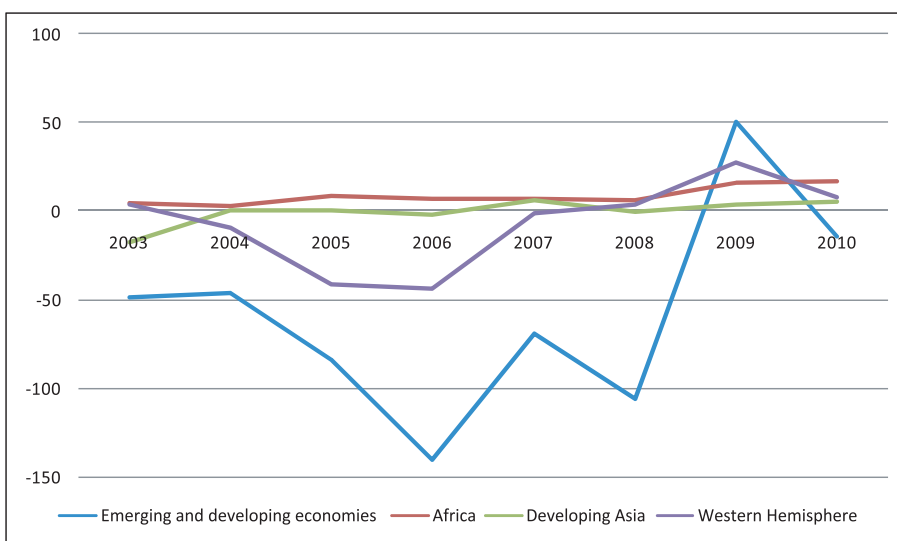


Figure 2: Official Development Assistance to Developing Countries, Net (in US\$ billions)
Source: Compiled by the author based on IMF (2010) *World Economic Outlook*, 2010, online.

most important criteria of an effective donor are deep commitment to the process of development (e.g. poverty reduction goals), responsiveness to developing countries' challenges and circumstances, and support for recipient-government policy.

Some studies confirm that donors' policies on trade, investment and aid do

the government and the proactive role of economic policy, especially in a more globalized environment.⁸ The experience of many of the newly industrialized countries, particularly East-Asian economies such as South Korea and China, serves as testimony that state-led development policy can be successful.

“Efforts should aim at establishing long-term coherence between trade policy, financial policy and development”

not contribute to development and poverty reduction; rather, in East Asia for example, autonomous policy efforts were to thank for successful performance. The economic relationship between the East-Asian region and OECD countries was unfavourable for the developing partners.⁷ OECD members' policies on tariff escalation and non-tariff barriers, particularly for processed products, have adverse effects on the development of food industries as well as on potential sources of employment, value added and scientific progress of developing partners.

Development Policy Impacts: Policy Space and Transmission Mechanisms

Policy Space

Institutional and policy reforms are usually considered to be the way to improve economic performance and growth in poor countries. Widely-promoted and researched reforms over the past two decades include trade openness and industrial policy reforms, financial liberalization, privatization of state-owned enterprises, fiscal and monetary policy reforms, and judicial development. In this regard, there are clear voices calling for a greater role of

Globalization has contributed to the improvement of the overall economic performance of developing countries by opening up market opportunities for their exports; by promoting the transfer of information, skills and technology; and by increasing the financial resources available for investment. But increased integration has also brought new challenges for growth and sustainable development. Some nations have successfully adapted to the changes and profited from globalization, but others have been less successful in reaping the benefits. Growing political and economic integration, and the commitments inherent to bilateral and multilateral relationships, limit the ability of developing countries to pursue national development policies. This means that policy space, defined as “the scope for domestic policies, especially in the areas of trade, investment and industrial development”,⁹ is now often framed by international disciplines, commitments and global market considerations.

There is a large body of literature arguing that the multilateral trading system is eroding the ability of nations to implement policies for growth and sustainable development, by narrowing the range of possible policy options allowable under international trade



and finance accords. In light of today's economic and social disparities the rationale for upholding policy space in trade negotiations is justified more than ever.¹⁰ That is, multilateral trading systems can have adverse effects on countries at earlier stages of economic development. International trade agreements have seemingly

Policy space and the effectiveness of national policy instruments are affected not only by international rules, but also by global market conditions and by the policy decisions of other countries. Moreover, global integration affects policy space through several factors that work in opposite directions; the effect on policy space differs according

developing countries with mutual interest (i.e. South-South and triangular cooperation) should be fostered.

Emerging Development Issues

Addressing Global Challenges

To improve development policy coherence donors need jointly to address per-

“The completion of pending international commitments, such as the Doha Development Round, is fundamental”

equivalent rules for all parties, but provide lesser policy space for the developing countries than the developed ones because of differences in initial conditions and institutional capabilities.¹¹ It is often proposed that special and differential treatment for developing countries, permitted under the World Trade Organization (WTO) rules, needs to be enhanced and made more effective in order to ensure that developing countries have essential national policy space for development.

A Balance between Policy Goals and Instruments

A meaningful policy space must extend beyond trade policy and include macroeconomic and exchange-rate policies that will help to achieve development goals. Considerable policy autonomy in macroeconomic and exchange-rate policies in developing countries still remains. This is particularly the case for the increasing number of developing countries which have a strong external position—either because of substantial revenues from commodity exports or a deliberate accumulation of foreign-exchange reserves—and which are not subject to International Financial Institutions (IFIs) or donor conditionality.¹²

to country and the type of integration.¹³ While integration into global markets might reduce the efficiency and scope of national macroeconomic policies, it can improve the effectiveness of many structural policies that are of crucial importance for developing countries—notably industry-wide strategies and technological upgrading, especially during the initial stages of industrialization. That is, economic integration facilitates access to foreign technologies and, at the same time, the foreign exchange from exports alleviates balance-of-payment constraints.¹⁴

The impact of external constraints on national economic policies, including multilateral rules and obligations, set up without the inclusive participation of all countries concerned and biased against the interests of some country groups, has impacted the scope and effectiveness of national policy instruments. Therefore, appropriate action needs to be taken at the international level to reduce the exposure of developing countries to adverse spillover effects and negative externalities from external policies. This implies that, alongside promoting multilateral solutions that address trade and financial systems imbalances, as well as inconsistencies in governance, regional collaboration and cooperation amongst

sisting global challenges, i.e. climate change, trade, capital flows and migration. That is, efforts should aim at establishing long-term coherence between trade policy, financial policy and development. A comprehensive plan focussing on issues concerning agriculture, competition, development partnership and governance, foreign investment, knowledge and innovation, sustainable development, and trade and fiscal policy needs to be devised. According to the OECD,¹ this plan could encompass the following actions:

- Improve market access for manufactures; reduce technical and quantitative restrictions to trade; relax agriculture and fisheries policies which have lasting negative spillover effects in developing countries; and, at the same time, provide improved market-access and technical support.
- Strengthen the framework for international investment and capital flows—both official and in the form of private investment (remittances, FDI, etc.).
- Reconcile environmental concerns with the broader trade and investment, and development systems.
- Rethink the role of international migration for economic and social progress in low- and middle-income countries.



Expanding Global Partnership

In response to existing development challenges, and to counteract exogenous shocks such as the recent global economic downturn, both developing countries and the donor community have sought not only more financial flows, but also better financial opportunities. These include, inter alia, joint ventures that mobilize private finance for public service delivery, risk mitigation efforts that promote private entry in the productive sectors, and support for carbon trading.¹⁵ Thus, innovative financial mechanisms have emerged or are being proposed, with the increasing participation of private agents and public–private partnerships. Yet, innovative fund-raising should be viewed as a complement to—rather than a substitute for—traditional efforts to mobilize official flows, in particular concessional flows. Donors should be realistic about the potential of innovative schemes to generate additional flows, and associated risks such as aid proliferation and associated transaction costs.

The Way Forward

Potential gains from growth and global integration can be halted by the incoherence in development policy that results from asymmetric development levels, as well as policy design and implementation, thus affecting collective governance. In line with challenges discussed herein, to achieve policy coherence donors and IFIs need to ensure security and political stability; foresee the impacts of macroeconomic policies on developing-country growth; increase both market access and capacity-building for developing economies; support governance structures that

help to maintain financial stability; and improve aid effectiveness in developing countries. In this regard, the completion of pending international commitments, such as the Doha Development Round, is fundamental. The monitor-

ing and evaluation process for policy coherence remains a challenge. These mechanisms need to have a more context-specific basis, with an emphasis on comparative country case studies of development policy coherence.

Notes

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