Ministry of Foreign Affairs
Republic of Costa Rica

Towards the Costa Rica Consensus:
Development as an Ethical Imperative.

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Introduction

1. Development is about transforming the lives of people. For it to be truly meaningful and successful, it must focus on increasing living standards in order to guarantee every individual, at the very least, the freedom from want and the freedom from fear.[1] For the purposes of this paper, development is about results: expanding opportunities and capacities and improving the well-being of the disadvantaged, of those that still do not live in larger freedom.

2. In that regard, in 2000 at the United Nations Millennium Summit, the international community reached a historic compact of shared but differentiated responsibilities in regards to development. This compact belatedly emerged from the recognition of our interdependence, from the recognition that poverty, inequality and all of their accompanying ills do not need a passport to migrate.

3. This compact, a global partnership for development as identified in the eighth Millennium Development Goal (MDG), has yet to become a reality. Although there have been significant advances, and some industrialized countries have already reached (and in some cases surpassed) the 0.7 percent of GDP in official development assistance, there is increasing evidence that the MDGs will not be reached without significant additional funding.

[1] This working paper will not deal with the other core freedoms and how a particular type of policy environment can determine the enjoyment or not of these freedoms.

4. As the 2015 target approaches, the question of how best to enhance the impact of development assistance has become more pressing than ever. The Monterrey Summit, the Rome Declaration on Aid Harmonization and Simplification, the Paris Declaration on Aid Effectiveness, and a series of evaluations on development effectiveness, including the annual UNDP Development Effectiveness Report, among others, have helped to progressively zero in on our shared but differentiated responsibilities regarding this development compact. Whereas donors have sought to improve the quality of aid, recipient countries have sought to improve country capacity.

5. These concerns are mutually reinforcing. As expressed in the *In Larger Freedom Report* produced by the Secretary-General of the United Nations, "*developed countries, on their side, undertake that developing countries which adopt transparent, credible and properly costed development strategies will receive the full support they need, in the form of increased development assistance, a more development-oriented trade system and wider and deeper debt relief. All of this has been promised but not delivered.*"[2] This is precisely the staging point for the Costa Rica Consensus.

The Costa Rica Consensus

6. The Costa Rica Consensus emerges from the conviction that development policies, strategies and priorities cannot be

[2] Kofi Annan. *In Larger Freedom: Towards Development, Security and Human Rights for All*. United Nations. Document A/59/2005. 21 March 2005. paragraph 32. p.12.

imposed on countries, that they need to be owned in order to be truly successful. However, it also emerges from the firm conviction that there should be a parallel track of selectivity rewarding developing countries that have proven track records for using resources well.

7. As enunciated by President Oscar Arias, "*with this initiative, we aspire to the establishment of mechanisms to pardon debts and sustain with financial resources those developing countries that increasingly invest more in public health, education and housing and increasingly spend less in weapons and soldiers. It is time for the international community to reward not only those that spend in an orderly fashion, but also those that spend ethically.*"[3]

Increasing and Rewarding Social Spending

8. The Costa Rica Consensus calls on all developing countries to do their utmost to invest their scarce public resources in addressing the most pressing social needs, including those identified in the MDGs. It accepts that the differences and particularities that exist within developing countries do not allow for a one-size-fits-all solution, but it nevertheless is grounded on the fact that many countries are not always doing their best to address poverty, inequality and their accompanying ills. It is grounded on the premise that government spending priorities should be appropriately aligned with the most pressing social needs challenging each developing country.

[3] President Oscar Arias. "Escojo la Vida, la Democracia y el Desafío de Cambiar en Paz". Inaugural Address. May 8, 2006. San José, Costa Rica.

9. On the other hand, the Costa Rica Consensus calls on donors to reward those developing countries that maximize social spending in enabling them to qualify for bilateral or multilateral credits, grants, loans, debt cancellation, and other development assistance programs, without imposing early graduation thresholds. No developing country should be graduated from development assistance because it has had success in tackling poverty and inequality and managed to move to the middle- income country category. The low-income/middle-income country categorization fails to take into account the diverse challenges and vulnerabilities facing developing countries and the underlying causes of poverty in each society. As demonstrated by a World Bank report, between 1980 and 2000, not less than 38 developing countries fell back from middle- income to low-income country status, with only 10 managing to eventually bounce back to middle-income country status.[4] The possibility of more middle-income countries falling back is a reality the international donor community must contend with. No country should be punished because it is no longer sufficiently poor— much too frequently the gains are much too fragile and remain vulnerable to both internal and external shocks.

Reducing Military Spending

10. In addition, the Costa Rica Consensus calls for a reduction in military spending, which is a major claim on scarce public resources. As pointed out by Collier, "*at best, these idle*

[4] Department for Internacional Development. "Achieving the Millennium Development Goals: The Middle-Income Countries (A Strategy for DFID: 2005-2008). London. 2003. Box.2 p.5.

resources function as deterrence."[5] Costa Rica does not question that there are legitimate security concerns, and that there are reasonable grounds to justify some degree of military spending. However, there is growing empirical evidence that there is "excess" military spending. Globally, average military spending relative to GDP stands at 3.4 percent, with important variations from region to region and country to country. This "excess" military spending can and must be put to better use addressing the wants and fears of those that do not yet enjoy a life in larger freedom.

11. Moreover, military spending also affects development financing in that it generates a neighbourhood public bad. Not only does it create a dysfunctional interdependence in terms of benchmarking between countries, which leads to increased military spending (with the added cost of the so-called "arms race multiplier"), but it also raises the possibility of conflict and the subsequent aggravation of the development challenge.[6] In this regard, one of the more revealing findings made by Collier, is the previously unrecognized positive impact that a non-threatening neighbour has on the military spending level of its neighbours— a net average reduction of 12 percent. These are tangible peace dividends.

12. Although inadvertently, development assistance does play a role in financing military spending. The fungible nature of money means that there are ways in which development assistance can have the indirect effect of increasing military spending. Fungibility simply refers to the fact that money going in for one purpose frees up other money for another use. Moreover, development assistance usually has some degree of legitimate leakage into government coffers (duties, taxes, commissions, and other operating costs), which can also have the indirect effect of augmenting military spending. According to Collier, on average around 11 percent of development assistance inadvertently ends up increasing the military spending of recipient countries.[7] Clearly, at least in part, the impact of development assistance may have nothing to do with its intended purpose.

[5] Paul Collier. "Regional Coordination for Reduced Military Spending: Potential and Design". Oxford University. February 2007. (unpublished). p.3.

[6] For a more detailed analysis of the cumulative complications that generally make chosen levels of military spending liable to be excessive, see Paul Collier. *Ibid*. pp.5-8.

Improving Reporting and Accounting Standards

13. These indirect effects of development assistance also raise the urgent need for donors to follow correct, transparent and consistent reporting procedures for ODA, and for recipient countries to provide increased accountability and traceability in the actual use of development assistance. In abiding with the ethical spending called for in the Costa Rica Consensus, there are no reasonable grounds for the allocation and execution of development assistance not to be fully accountable and traceable.

14. The absence of fully harmonized reporting and accounting standards, both in terms of government spending and development financing, is an important factor to consider in designing the mechanics of the Costa Rica Consensus. Despite recent efforts at harmonization, there continue to be

[7] Paul Collier. *Ibid.* p.13.

significant variations in official reporting and accounting standards. This obviously raises important questions as to the true comparability of spending and financing figures across countries. However, there are sources that are generally accepted to be authoritative in terms of quantifying and disaggregating both government spending and development financing: the annual reports published by the United Nations Development Program (UNDP) and the World Bank for social spending, the annual data sets of the World Bank and the Stockholm International Peace Research Institute (SIPRI) for military spending, and the annual official development assistance tables compiled by the Organization for Economic Cooperation and Development (OECD).

15. Before the Costa Rica Consensus becomes fully operational across countries and regions, it is necessary to identify and agree to a comparable and verifiable standard of reporting and accounting social spending vs. military spending. This, however, should not delay the consideration and application of incentives to reward those developing countries that, on a case by case basis, are verifiably making and maintaining sustained efforts to increase social spending and reduce military spending.

Operationalizing the Consensus

16. The Costa Rica Consensus intends to complement existing development assistance schemes. It does not seek to decrease the allocation of aid to low-income countries or other middle-income countries and thereby create a zero-sum competition for scarce development financing. On the contrary, it appeals to donors, as they comply with the 0.7 percent of GDP target, to make available a fraction of the increases to reward those developing countries that are practicing ethical spending. All developing countries have the potential to do so, it is simply a matter of political will. There are no conditionalities that permanently exclude any developing country from accessing the parallel and supplemental track of incentives contemplated by the Costa Rica Consensus. Moreover, in advocating for increased social spending and reduced military spending, the Costa Rica Consensus essentially guarantees that the net impact of development aid will be greater than the sum of its parts.

17. Since the initial appeal made by President Arias for the international community to join the Costa Rica Consensus, some donors have been giving due consideration to the appeal. Some of the donor countries have however indicated that legal restrictions that tie development assistance to low-income countries and, in some cases, to lower middle-income countries, restrict their capacity to respond favourably. Some have however indicated that they are politically committed to the Costa Rica Consensus and its invitation to reward ethical spending and have announced that they are studying ways to make development assistance available to countries that have proven track records for using resources ethically.

18. The Costa Rica Consensus obviously needs to be appropriately resourced to selectively reward those developing countries that meet the eligibility requirements. The most expedient and efficient way to turn the Costa Rica Consensus into a reality in practice, is for donor countries to internalize the thinking behind the Costa Rica Consensus in their official development assistance programs. To this end, OECD-DAC countries are called upon to contemplate incentives, such as debt reductions (condoned or swapped), grants and/or loans with subsidized interest rates, to reward the peace dividends potentially or actually generated by a developing country,

19. Following wide consultations with a diverse group of development experts from the United Nations System and the international financial institutions, two additional potential incentive mechanisms have been identified: an International Peace Dividend Fund (IPDF) and an Interest Buy-Down Subsidy Facility (IBSF) for both bilateral and multilateral loans.

20. The International Peace Dividend Fund would be financed by voluntary contributions made by donor countries as part of the development aid they are to make available in meeting the 0.7 percent of GDP commitment. The Fund could be potentially administered by the United Nations Development Program (UNDP), with a steering committee that would be responsible for determining eligibility and administering the disbursement of resources. The composition of the Steering Committee and the eligibility requirements still need to be refined and determined. Moreover, further consultations are necessary to secure a stable and suitable replenishment mechanism for the Fund.

21. The Interest Buy-Down Subsidy would operate for both bilateral and multilateral loans that are granted within the framework of the Costa Rica Consensus. The buy-down would be conditional on the level of compliance of the eligible developing countries in reducing or keeping military spending at reasonable levels. Any increase in military spending would automatically trigger the expiry of the buy-down and the accrual of the subsidized interest. A wide array of interest buy-downs could be potentially available, from particular donor country subsidies at the bilateral level to more expanded finance facilities at the multilateral level.

The Case of Costa Rica

22. The Costa Rica Consensus is not a new paradigm. Although it builds on previous efforts to make better sense and use of government spending and development financing priorities, it is directly inspired by the graduation of Costa Rica from development assistance. Although the country has had a long standing commitment to human development, dating back to 1869 and the constitutional right to a free primary education and the constitutional abolition of the military in 1948, over the past decade the country has been largely punished by the international donor community despite its cumulative and sustained accomplishments.

23. Because it is a middle-income country ($4,590 per capita in 2005) with a high human development index (0.841 in 2006), it has systematically been graduated from most development assistance programs, notwithstanding that it still faces important development challenges. Among these, the country has not been able to dent the poverty affecting 20 percent of the population. In fact, although poverty has stagnated at 20 percent, inequality has increased consistently over the past 5 years. Moreover, over the last three decades, the country has generously accepted hundreds of thousands of migrants from neighbouring countries (about 15 percent of the total population), financing their right to public health and education despite important fiscal limitations while favouring a net outflow of remittances to neighbouring countries.

Conclusion

24. Without a shared but differentiated commitment to ethical spending by donors and recipient countries alike, it will be increasingly difficult to overcome the development challenge that we face in our interdependent world. Donors and recipient countries are, and should be on a more consistent basis, moral agents, with duties and responsibilities to one another and as well as to their own societies. This is the essence of the Costa Rica Consensus.