



INVESTING IN REGIONAL PROSPERITY:

Positioning the aid program to support Australia's economic partnerships in Asia

NOVEMBER 2018

Nearly three-quarters of the world's poor live in middle-income countries (MICs). Despite this, many bilateral donors—including Canada, Denmark, the Netherlands, Sweden and the United Kingdom—are transitioning away from providing aid to MICs and instead concentrating on low-income countries and fragile states.

Australian development assistance in MICs adds value by helping partner countries mobilise resources and improve the quality of their spending. Australia stands to benefit from measures that promote more open and prosperous national economies and greater regional economic integration.

Through Australia's economic partnerships in Asia, the aid program has achieved some impressive results. To support more ambitious partnerships, the Department of Foreign Affairs and Trade (DFAT) needs to adapt its systems and strengthen staff capabilities.

THE EVALUATION

Focusing on two case study countries—Indonesia and Vietnam—and a selection of South East Asia regional programs, this evaluation assessed how Australian development assistance is evolving from traditional donor-recipient relationships towards economic partnerships (Box 1).

This evaluation found a strong case for Australia to remain engaged in Asian MICs and continue to build its comparative advantage as a partner on economic and social reform.

This is because:

- working with MICs is essential to achieving global development objectives
- addressing regional challenges, such as climate change and cross-border health threats, depends on the capacity of MICs
- without complex reforms, MICs could face stagnation and rising inequality with impacts on regional security
- the aid program has already cultivated deep and broad relationships with key decision makers that provides DFAT with access to work on issues of mutual interest with partners.

Box 1: What is an economic partnership?

Economic partnership refers to a relationship built on a shared interest in deeper bilateral economic ties and mutual prosperity.

The term emerged in recognition that Asia needs a different approach to development assistance.

Development assistance in Asian MICs increasingly focuses on knowledge-based assistance, such as technical assistance, capacity building and efforts to support reformers and reform initiatives.

RESULTS

Australian aid is modest compared to the overall levels of development finance available to Asian MICs, however the evaluation found that knowledge-based assistance can produce transformational results. Australian aid has been used to pilot economic and social reforms and leverage larger investments from multilateral development banks and national budgets. Positive results have also been achieved from programs supporting reformers and reform initiatives (Box 2). Policy and institutional reforms are, however, subject to factors beyond Australia's control and are never guaranteed.

Box 2: Towards a Strong and Prosperous Indonesian Society (MAHKOTA Indonesia)

Through the MAHKOTA program (2016–19) and the Poverty Reduction Support Facility (2010–15), DFAT supported Indonesia's National Team for Accelerating Poverty Reduction. This team is a social policy think tank that developed a database enabling more targeted social assistance programs. These programs led to a reduction in untargeted electricity subsidies, with savings to the Indonesian budget of an estimated A\$1.6 billion in 2017. DFAT's programs were instrumental in building and sustaining political support for these reforms.

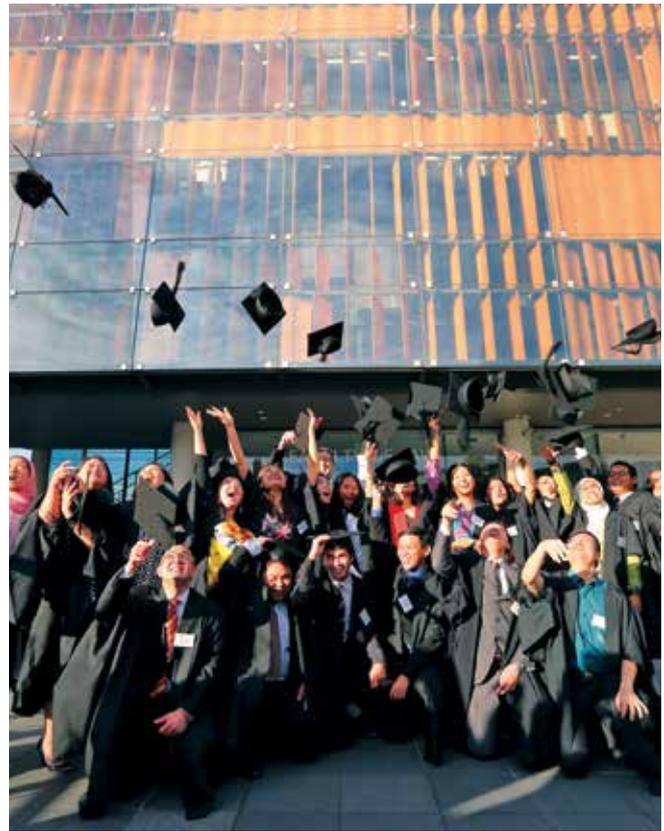
EFFECTIVE APPROACHES

The evaluation identified approaches that have proven effective in supporting economic partnerships with MICs in Asia. Each approach has benefits and challenges.

Economic governance facilities enable DFAT to deploy technical assistance to support economic and/or social policy reform. The model permits flexible use of funds, within an overarching set of objectives. However, these facilities can be challenging to set up and require careful management to ensure they are used strategically.

Peer-to-peer partnerships can be effective at building sustainable bilateral links. Counterparts value the opportunity to work with Australian peers, but it can be difficult to find the right person to support high-priority reforms of partner agencies.

Multilateral development bank trust funds can bring technical expertise and credibility to the economic partnership. Multilateral development banks can also challenge partner countries on their policy choices in ways that would be inappropriate for a bilateral donor. Experience shows that trust funds work better when DFAT is actively involved with programs.



Australian Award farewell at the University of Sydney. Scholarships have been an important feature of Australian assistance to MICs and can be targeted to support the objectives of economic partnerships by building links with Australia at institutional and individual levels. Image: DFAT photo library, 2014

Investing in **pilot and demonstration** infrastructure activities can be effective to support economic partnerships, but it can be difficult to maximise reform opportunities (Box 3). Australian development finance is modest compared to other financing options available to MICs. Australia's value-add in infrastructure is in helping partner countries improve the quality of their spending, supporting them to be informed consumers of other sources of development finance and to manage debt levels sustainably.

The evaluation found that to be an effective partner in reforms, Australia needs to:

- build long-term relationships with key counterparts and reformers
- ensure investments are flexible enough to scale individual activities up or down as the context evolves
- actively engage with multilateral development bank trust funds to support broad coalitions of change
- provide sustained support, even after reforms are implemented.

Box 3: Infrastructure investments in Asian middle-income countries

If pilots or demonstrations are to be influential, the evaluation found they need to be explicit about objectives and be carefully integrated into national decision-making processes.

Managing large infrastructure budgets can divert DFAT staff from focusing on potentially more strategic support for policy and institutional reform.

The evaluation concluded that Australian assistance adds value by strengthening the overall quality of partner country's national infrastructure investments. This differentiates Australian support from other countries that only offer finance.

ALIGNING AID, TRADE AND DIPLOMACY

Aligning aid with trade and diplomatic efforts in pursuit of mutual prosperity is an objective of Australia's economic partnerships. Under these partnerships, technical assistance and capacity building can and has provided high-profile opportunities for diplomatic engagement. The evaluation also found that DFAT is appropriately cautious in using aid to support bilateral trade, to avoid compromising its effectiveness.

The evaluation identified opportunities to improve the complementarity of aid, diplomatic and trade initiatives to strengthen economic partnerships.

- There is scope for DFAT to **use aid programs more effectively as a platform for diplomatic engagement**. This requires explicit goals to be pursued more consistently and strategically.
- Australia is negotiating bilateral and regional free trade agreements which include pledges of Australian support to help partner countries take advantage of the agreements. These **more ambitious trade agreements offer an opportunity to use Australian aid to promote reforms** that deepen trade and investment ties, with benefits to both countries.

- There may be scope to **target aid towards sectors that offer opportunities for mutual benefits**. For example, Australian support for vocational training in Indonesia could create opportunities for Australian firms and help address skills gaps in Indonesia. In doing so, it is important for Australia to be transparent about its interest and ensure that the interests of both countries are complementary, rather than competitive. It is also important to ensure that programs comply with international Official Development Assistance definitions and follow the principles of good development practice.



The My Thuan bridge and other large infrastructure investments have been an important feature of Australia's past engagement with Vietnam. In support of economic partnerships, Australian assistance is transitioning towards a greater focus on technical assistance and capacity building within Asian MICs. Photo: Opening of My Thuan bridge, Vietnam 2007. Image: DFAT photo library



The new Australian Embassy in Jakarta. Image: John Gollings, DFAT photo library

SYSTEMS AND CAPABILITIES

The evaluation found that economic partnerships require different skills and capabilities to those needed in more traditional donor-recipient relationships. For example, knowledge-based assistance often requires greater management, relative to expenditure. This is because more oversight is needed to ensure this assistance is flexible and adaptive, while remaining focused on strategic objectives. Effective economic partnerships also rely on staff economic literacy for DFAT to make the most of opportunities presented through these partnerships, and more readily understand and engage in policy debates.

To maximise the effectiveness of Australia's aid in strengthening economic partnerships, there is a need to build a greater understanding of:

- opportunities for, and constraints on, achieving more productive economies in Asian MICs
- causes of inequality, including barriers preventing poor and marginalised groups from benefiting from economic growth, and the risks that inequality poses to growth and stability
- key institutional and policy gaps for economic transition, and the constituencies that support or resist reform
- risks that could set back economic growth, such as climate change, demographic shifts or financial crises, and how to mitigate their impact.

Recommendations

The evaluation recommendations, and DFAT's management response, centre on:

- Providing clear strategic direction on the case for continued development cooperation with MICs and the need to identify clear objectives within each economic partnership.
- Conducting further analytical work on the needs and challenges for MICs.
- Providing stronger technical expertise and guidance on the design and implementation of influential knowledge-based assistance.
- Investing in skills and capabilities so staff can better identify opportunities for knowledge-based assistance, engage in policy dialogue and manage knowledge-based programs and portfolios at a strategic level.

Office of Development Effectiveness

The Office of Development Effectiveness (ODE) is an independent branch within the Department of Foreign Affairs and Trade. ODE monitors the Australian aid program's performance, evaluates its impact, and contributes to international evidence and debate about aid and development effectiveness.

The full evaluation report and DFAT management response can be accessed at www.ode.dfat.gov.au.