

RETHINKING THE ROLES OF MULTILATERALS IN THE GLOBAL AID ARCHITECTURE

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Executive Summary

The multilateral aid agencies are an important pillar of the global aid architecture, but the multilateral system is increasingly fragmented with overlapping responsibilities between agencies. The core, country-based multilateral system faces challenges of governance, legitimacy and effectiveness, as development knowledge moves from a “technical expert” phase to a “power of the many” phase. At the same time, earmarked vertical funds and trust funds are playing a noticeably larger role in the multilateral system. These developments call for a rethinking of the core comparative advantages of multilateral agencies in the global aid architecture—one that takes into account their strength in addressing global public goods, le-

veraging resources, their role in fostering knowledge for development and their tolerance of risk.

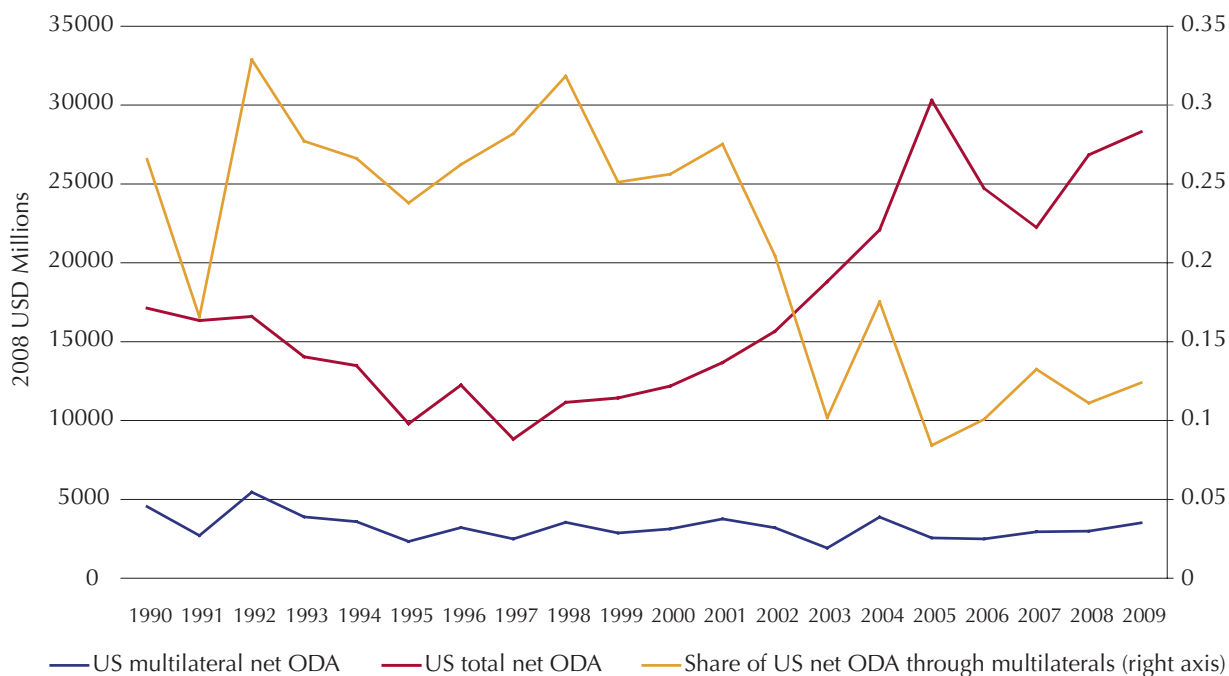
What Is the Issue?

Multilateral aid agencies are an important pillar of the global aid architecture, accounting for about a quarter of net disbursements of official development assistance (ODA). Over time, the number of multilateral aid agencies has proliferated—today there are 263 agencies funded by rich-country governments. One of the newest multilateral agencies, the European Commission, has become the second-largest aid donor in the world since 2008. And the concessional facilities of the multilateral development banks expect to receive substantial replenishments this year.

On the face of it, this evidence would suggest that the multilateral system is healthy and vibrant. But the system is increasingly fragmented, with overlapping responsibilities between agencies. It faces challenges of governance, legitimacy and effectiveness. Excluding the European Commission, which operates in many ways more like a bilateral rather than a multilateral donor, the multilateral system only accounts for 16 percent of total ODA. More and more donors find it politically easier to channel their resources through their own bilateral systems or by creating new, narrower agencies to address particular issues under specific governance arrangements.

The most striking sign of the reduced role for multilaterals is the declining leadership of the United States in multilaterals. Since 2000, U.S. ODA has increased significantly by almost 10 percent a year in real terms (see figure 1). But U.S. aid channeled through the multilateral system has stagnated. The increase in U.S. assistance has been through new bilateral programs like the President's Emergency Plan for AIDS Relief and the Millennium Challenge Corporation. As a result, the share of U.S. foreign assistance channeled through the multilateral system has fallen to 11 percent, less than half its level in 2000. In comparison, the United Kingdom gives one-third of its foreign assistance through multilateral organizations.

Figure 1. U.S. Bilateral and Multilateral Foreign Assistance



Source: OECD DAC Table 1 ODA Disbursements, 2010

Other indicators reveal the same problem. Only 12 percent of U.S. aid missions are coordinated with those of other donors, according to the OECD's Development Assistance Committee. And only one-third of U.S. analytical work on development problems is done jointly with other development partners.

Until 2005, the U.S. had systematically been the largest donor to every multilateral development fund. But it lost this spot in the World Bank's 14th International Development Association (IDA) replenishment to the U.K. and became the fourth-largest donor to the African Development Fund's 10th replenishment, after the U.K., France and Germany.

Whither Multilateralism?

Multilateralism is being questioned because its initial *raison d'être* has disappeared. When IDA was founded in 1960 as the World Bank's concessional lending arm, multilateral aid approaches were conceived of as (1) encouraging equitable burden sharing across donors, (2) reducing transaction costs by pooling resources into larger country programs and (3) building a critical mass of development professionals to share global knowledge and expertise.

Today, the volume of aid is no longer tied to multilateral commitments. It is still modestly influenced by collective action through pledges made at global summits like the Group of Eight and common European commitments to set joint aid targets. However, some large donors have found that domestic political support is more easily obtained for domestic aid programs than for multilateral programs. In today's severely resource-constrained environment, there is a premium on innovation, impact and aid exit strategies that is being pursued by trying new ways of doing business.

Similarly, multilaterals no longer enjoy a major advantage in having low transaction costs. Their compliance procedures have become more cumbersome and costly while technology has helped smaller donors operate with low transaction costs. South Korea, Spain and Portugal provide aid with administrative costs of 4 to 5 cents per \$1 disbursed, while IDA and the African Development Fund have administrative expenses of around 10 to 12 cents per \$1 disbursed (table 1).

Significant development knowledge is still embedded in the staffs of multilateral agencies. More than 200

Table 1. Why Provide Multilateral Assistance?

Pros	Cons
Economies of scale	Perceived institutional complexity
Political neutrality and legitimacy	Lack of transparency
Scale of resources (capital and knowledge)	Higher absolute costs
Low transaction costs per unit of output	Remoteness and lack of accountability
Provision of public goods	Insufficient evidence of multilateral effectiveness

Source: Development Assistance Committee, OECD, 2010 Multilateral Aid Report.

multilateral agencies do not have a resource transfer mandate but are normative and standard-setting bodies. They absorb about 18 percent of multilateral ODA, but their work is not well understood by the public. More striking is the veritable explosion of local knowledge about what works in specific country settings. Development-focused civil society organizations and community-based organizations number in the hundreds of thousands. Development knowledge is moving from a “technical expert” phase to a “power of the many” phase. Greater clarity about the core mission of each multilateral is needed as a benchmark against which to assess efficiency and effectiveness.

These three developments call for a rethinking of the core comparative advantage of multilateral agencies in the global aid architecture—one that is already visibly shifting the nature of multilateralism.

Two important new trends in multilateralism are vertical funds and trust funds. Vertical funds, most notably the Global Fund to Fight AIDS, Tuberculosis and Malaria, provide a greater sectoral focus and hence an easier link between resources and development outcomes. The Global Fund has already committed \$19.3 billion in 144 countries since 2002, showing its advantages in terms of speed and scale compared with traditional multilateral structures. The newest vertical fund, the Global Agriculture and Food Security Program, was launched in April 2010, signaling a continued interest by donors in such approaches.

Features of the new vertical funds show the emergence of a new form of multilateralism. These include:

- A clearly specified results-chain.
- More representative governance with a balance between donors and recipients on the executive boards and participation from civil society organizations.
- Stronger private-sector participation in the delivery of fund programs, with explicit private-sector windows in some cases.
- A strong commitment to transparency, evaluation and learning.
- A framework where recipient countries compete for resources via the quality of their funding requests.
- Time-bound programs, in some cases, to instill a sense of urgency.
- A clear approach to global public goods.

Trust funds are another rapidly growing part of the multilateral system. These funds are administered by multilateral agencies on behalf of bilateral donors. They currently disburse \$14 billion a year, almost 40 percent of core multilateral funding. Trust funds can be used by donors to target specific sectors, areas or countries of interest. For example, trust funds are heavily used to respond to humanitarian disasters (the World Food Program is among the largest beneficiaries) or for specific purposes that fall outside the normal multilateral structures (such as Timor-Leste in its immediate postindependence phase and Kosovo). Trust funds have been used for knowledge for development, aid for trade, and various environmental and energy efficiency programs. On the margin, trust

funds can affect the overall allocation of resources, although there is some evidence that easily available trust fund grants can crowd out regular aid allocations to the same countries or sectors.

Trust funds and vertical funds reflect the inherent tensions in multilateral aid. From the point of view of aid effectiveness, core multilateral funding allows for maximum flexibility and a potential ability to respond to the needs of recipient countries. Conversely, the new funds offer earmarking and focus as game changers that can produce results with speed, scale and efficiency.

Issues for Multilateral Aid

The four main issues for multilateral aid include the appropriate multilateral share of total aid; whether to stop creating new agencies, and which multilateral agencies deserve support; whether multilaterals are the best channels for knowledge exchange; and whether multilaterals can be better leveraged to raise resources for development. Here it is only possible to suggest the parameters of each issue.

Issue 1: What Is An Appropriate Multilateral Share of Total Aid?

Some forms of aid are best handled multilaterally. Funding for global public goods (GPGs) is a classic example of where multilateral aid channels are probably superior to bilateral programs. A multilateral structure can solve the collective action problems inherent in public goods, such as free riding, the prisoner's dilemma and the tragedy of the commons. Free riding is a problem of getting agreement on funding, which is nontrivial, as demonstrated by the climate change discussions. The prisoner's dilemma is a problem of getting coordinated action when incentives and priorities for implementation differ among coun-

tries. And the tragedy of the commons is a problem of legitimacy, participation and agreeing to a consensus among all parties. Multilaterals have shown flexibility in funding, incentivization and governance and representation to resolve these problems flexibly for a variety of different public goods.

As the International Task Force on Global Public Goods suggested in 2006, GPGs are significantly underfunded at present. Thus, it makes sense to expand the multilateral share of aid. For more traditional development aid, multilateral agencies must reform to demonstrate greater effectiveness compared with bilateral aid agencies. Some research, however, does suggest that multilateral agencies have a greater development impact than bilateral agencies, with a greater share of their aid being used for programs in recipient countries, a greater orientation toward poor countries, more stability and predictability of disbursements, and less tying of aid.

On balance, a renewed emphasis on multilateralism appears to be warranted.

Issue 2: Should We Stop Creating New Agencies, and Which Multilateral Agencies Deserve Support?

Because traditional multilateral development funds are slow to change, the prospects are slim for efficiently reorienting existing multilateral funding toward GPGs. The trend toward new multilateral agencies to address specific GPGs is probably efficient, especially because there is little evidence that the administrative costs involved are any larger than if traditional multilateral funds were simply expanded. The Global Fund to Fight AIDS, Tuberculosis and Malaria, for example, has a relatively low share of administrative costs compared with other multilaterals.

The problem is more that existing multilateral agencies do not exit from GPG support activities when a new fund is created. Furthermore, within a particular GPG, a plethora of multilateral agencies has emerged. This could lead to fragmentation and waste.

Multilateral agencies have not embraced work on a division of labor to the extent that even some bilateral agencies have done. The bureaucratic pressures within multilateral agencies are biased toward expansion, not efficiency. There are no strategic meetings between the boards of major multilateral organizations. More political discussions are needed to improve coordination.

Through their funding, donors have the ability to shift resources between multilaterals and, over the past few years, there has been a distinct shift away from funding the UN specialized agencies and toward agencies like the Global Fund to Fight AIDS, Tuberculosis and Malaria. This seems to have emerged out of an informal assessment about effectiveness.

Donors should invest in more explicit measures of aid agency effectiveness, whereby bilateral and multilateral agencies could be compared. For example, the Multilateral Operational Performance Assessment Network is one mechanism for reviewing multilateral agencies, but all agencies are not reviewed on an annual basis. This assessment is based in part on surveys and the perceptions of those in its network. Several bilaterals also have their own strategies for multilateral development cooperation.

An approach based on funding decisions informed by assessments of multilateral effectiveness is more likely to shift resources toward more efficient agencies than the alternative approach of having a high-

level commission review and rationalize mandates across organizations. The latter would need to navigate complex political territory that could ultimately jeopardize the objective of a more efficient, rational multilateral system. Also, it would not be able to address the continued emergence of new multilaterals.

Issue 3: Are Multilaterals the Best Channels for Knowledge Exchange?

Ideas and knowledge are key ingredients in development, and multilateral development organizations have specialized staffs with a wealth of experience. Multilateral agencies are still the best sources of analytical diagnostic and capacity-building work on developing countries. They play a critical role in helping developing countries stay abreast of the relevant events and risks in the global economy, the country-level implementation of global codes and standards, the country-level development of robust markets and social and environmental assessments.

However, the demand for knowledge is shifting. South–South cooperation is flourishing because of a sense that experiences in other developing countries, as interpreted by practitioners, are more relevant for development than the experiences of advanced economies. The organization of this knowledge exchange, however, is underdeveloped. Multilateral agencies do not have significant representation from important countries in the South to help identify relevant solutions, and recipient countries are used to working with traditional donor structures that exclude middle-income countries. What is needed is a radical increase in the voting power of emerging donors, as well as other ways to engage them in multilateral organizations.

Organizing South–South exchanges in a more effective way is an appropriate challenge for multilateral agencies. It implies moving the concept of knowledge management away from capturing and disseminating internal organizational experiences and toward building platforms that facilitate knowledge exchange among large numbers of global practitioners. The form of these platforms—Web-based, event-based and transaction-based—is still evolving, but knowledge for development is certainly a GPG in which there is significant underinvestment.

Issue 4: Can Multilaterals Be Better Leveraged to Raise Resources for Development?

Because aid focuses on the poorest countries, some regions, like Latin America and Eastern Europe, are receiving ever-smaller shares of aid. Latin America only received 7 percent of total aid in 2008. However, many middle-income countries are growing vigorously and have the fiscal space to expand their indebtedness, thanks to reforms undertaken since the Latin American debt crises of the 1980s. These countries have turned to commercial capital markets to finance their development needs, only to find themselves subject to significant swings in access to these markets during the recent global financial and economic crisis.

Economies that do not have secure, stable financing cannot afford to take risks. Without multilateral support, middle-income countries have become

more cautious about spending, at the cost of slower expansion of infrastructure and social safety nets. Multilateral agencies have ceased to play a role in major development financing. In 2007, before the global financial and economic crisis, net disbursements from the major five multilateral development banks had fallen to roughly zero; that is to say, repayments of past loans to the MDBs from developing countries approximated total gross disbursements of \$23.4 billion. Even with the higher capital for MDBs that was recently approved, they will play a small role in the net transfer of resources to the developing world.

The most promising way for multilaterals to expand their lending more aggressively is to increase the leverage of loans relative to capital. Very conservative commercial banks operate with a loan-to-capital ratio of 6 to 1. The MDBs operate with a ratio of 1 to 1.

The alternative mechanism for leverage is by partnering with the private sector, especially in nonsovereign loans, which made up the fastest-growing portions of the MDBs' portfolios before the global financial and economic crisis. These nonsovereign flows provide flexibility in pricing country and project risk, so they are more suitable for private cofinancing arrangements. But nonsovereign lending is still only one-third of MDBs' total nonconcessional lending. A much higher share will be needed to expand leverage through this mechanism.