

DISCUSSION PAPER

VISION AND OPTIONS FOR CHANGE FOR THE INTERNATIONAL DEVELOPMENT  
ARCHITECTURE

**OVERVIEW (6 pages)**

*The difficulty lies not in new ideas but in escaping from old ones (Keynes)*

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# **VISION AND OPTIONS FOR CHANGE FOR THE INTERNATIONAL DEVELOPMENT ARCHITECTURE**

## **OVERVIEW**

### **Introduction**

The purpose of the paper is to encourage debate in DFID about the international development architecture. We define this “architecture” as the world’s agencies, institutions and systems for managing the transfer of resources (finance and expertise) to, and development relationships with, low-income countries. This paper should be read in the broader context of The White Paper on Globalisation (DFID, 2000), which covers a wider range of issues about the governance of globalisation, security and stability, and other policies (for example, on migration) which also affect low-income countries.

The paper reflects the views of the team that prepared it, and is not DFID policy. Indeed, what motivates the paper is the sense that DFID lacks a clear view of the appropriate medium-term roles of different actors in the international development architecture. These gaps in DFID policy make it difficult to pursue reform programmes or to compare agency effectiveness. Moreover, DFID is not alone in this regard. The overall development architecture has not been seriously evaluated and restructured since the 1960s and 1970s. Few changes were proposed at Monterrey.

The first part of the paper describes the development architecture and current policies towards it. It identifies some principles for an effective development architecture and considers how the system stacks up against them.

The remainder of the paper makes proposals and raises questions about the current architecture. We try to apply our principles to the overall working of the system and to the roles of different agencies and instruments within it. We look ahead to around 2010 and set out our ideas and raise questions about what an effective system should look like. All of our proposals are subject to the strong caveat that there has been no detailed consultation with poor countries about many of these issues.

### **The issues**

The rest of this overview identifies the ten main issues or problems identified in the paper and summarises our ideas and questions about the future.

The ten issues are:-

- I. Bilateral aid continues to constitute over 65% of Overseas Development Assistance (ODA) flows, but it: is not well co-ordinated; comes with very high transactions costs; operates without any binding rules or norms; and delivers a large volume of tied and ineffective technical assistance which is subject to virtually no normal economic tests. The two biggest donors, i.e. the US and Japan, are among the least progressive. Too many agencies are doing the same thing and too few of them have tried, let alone managed, to focus and prioritise.

- II. Humanitarian aid is a growing share of total ODA, comprising at least 8%<sup>1</sup> of ODA and possibly much more, but there are even fewer agreed rules or norms and no relevant Millennium Development Goal (MDG) to provide a unifying objective. The humanitarian response differs from best practice in development assistance because the nature of many modern conflicts is such that the response can not always work through government owned processes. The response to individual crises is often idiosyncratic, patterns of finance do not respond to need and the required co-ordination functions are seriously under-funded. The system spends far too much time trying to mobilise finance for each crisis as it unfolds and not enough effort on prevention.
- III. There are problems with overall aid allocation. Favourite country syndrome and small country bias risks over-aiding certain countries and under-aiding others, especially if the US Millennium Challenge Account comes on stream and donors are not prepared to play a *balancing* role. There are very different systems for countries falling either side of the International Development Association (IDA) definition of low-income, with no performance allocation models that span the low-income and lower-middle-income countries. Policies towards India and China are unclear.
- IV. Aid flows to individual countries are very volatile, hard to predict and decrease during poor-country recessions. The future of debt relief is uncertain. Aid contributes to macro-economic management problems and can sometimes reinforce the impact of shocks on poor people.
- V. The system overall lacks flexibility, it is slow to pick up on new ideas and since the 1940s it has no history of closures, exit or mergers. Strategies for dealing with the growing role of private foundations are unclear.
- VI. The United Nations (UN) development system has an inherent comparative advantage of legitimacy and developing country buy-in. However, it has been starved of core-funds, priorities are driven by the preferences of donors, it is struggling to organise effectively and to prioritise at country level.
- VII. The Regional Development Banks (RDBs) could be an essential part of the architecture. The RDBs have legitimacy but there are continuing concerns about effectiveness. Ambivalent attitudes by donors and other multilaterals are not helping to affirm the RDB's place in the architecture.
- VIII. The European Commission (EC) is unique among multilateral bodies. It could provide coherence between development goals and other policies, with the potential to organise and co-ordinate the aid policies of half of world ODA, making it a leading player within the architecture. Reforms have been slow to deliver effectiveness; there are problems of allocation in favour of middle- income countries and uncertainties about how big it should be.
- IX. The concessional arm of the World Bank (IDA) continues to dominate policy processes in-country and it finds it hard to let-go of heavy conditionality or embrace selectivity. Its instruments are unsophisticated and do not offer the predictability or flexibility required from a large financier.
- X. The low-income countries have very little voice within the system. They have no formal influence over bilateral policies and no effective voice over system-wide issues, such as the allocation of aid. At present, there are no credible structures for pursuing

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<sup>1</sup> Global Initiatives (2003) Global Humanitarian Assistance 2003. Prepared by Development Initiatives for the Humanitarian Financing Work Programme. <http://www.globalhumanitarianassistance.org>.

these issues. Within the multilateral banks poor country formal voice is diluted through the donor driven replenishment process.

## **Recommendations and questions**

Our main recommendations and questions for further discussion are:

### ***How can the transaction costs of multiple bilateral donor agencies be reduced?***

There needs to be a significant shift in the system to reduce transactions costs and increase voice for poor countries. Harmonisation processes are moving too slowly and Development Assistance Committee (DAC) peer reviews lack bite. We argue that the ratio of multilateral to bilateral aid must increase from 35:65 to at least 60:40. Within this, the EC could potentially sweep up smaller European aid programmes in total. Such a shift should be conditional on improvements in multilateral effectiveness, and new mechanisms for low-income country voice in replenishment processes.

Multilaterals should be focused on providing predictable, medium-term financing for poverty reduction strategies. They should work together to deliver aid which is counter-cyclical. IDA and/or the EC should act more like development financiers of last resort than first resort – taking on responsibility for balancing out misallocations in global aid flows.

### ***What should bilaterals do?***

Bilateral agencies should play similar medium term financing roles to the multilaterals but continue to help countries innovate, recognising that multilaterals can be risk averse. However, bilaterals should be prepared to consult with countries on whether they would prefer aid to be passed through multilaterals. As a second-best to multilateral financing, bilaterals should aim to pool at country level – albeit there are serious concerns about governance and transactions costs in such pooling.

### ***What role for technical assistance?***

We argue that it is not acceptable that over one-quarter of global ODA is off-budget and subject to virtually no opportunity cost or rate of return analysis. Finance for technical assistance should be provided untied and through budgets. Expertise should be contracted and managed by governments. UN specialised agencies should be supported as real centres of global expertise, helping countries to access international advice.

### ***Is there a future for debt relief, should multilaterals deliver grant finance?***

The place of grant finance in the multilateral system should be de-linked from historical agreements and precedent. IDA should deliver grants, but the volume should be driven from the bottom-up by country-based analyses of debt carrying capacity. IDA will need to have the flexibility to switch terms on a case-by-case basis.

There is no need for a new debt scheme post Heavily Indebted Poor Countries Phase 2 (HIPC 2). Instead, debt relief should be considered as an instrument, i.e. as one of several ways to disburse aid for poor countries. Many countries still have the capacity to absorb more concessional loan finance and a growing IDA need not be all on grant terms.

### ***How to manage shocks?***

The UN system must step up its engagement in national policy processes to ensure that issues of disaster prevention and shock management are properly tackled. The International Finance Institutions (IFIs) do not have the capacity or will to do this.

More generally, the whole system needs to be more flexible, recognising that models of graduation from crisis to recovery and growth are too simple. The overall system needs the flexibility to respond to continuing patterns of crises and shock, and to tailor responses to the specific context facing a country at any time.

The humanitarian aid system requires a significant shift in the way it is financed. It needs to become a genuine multilateral system with the ability to respond to need and uphold the principles of humanitarian law. Bilateral donors must stop tying their aid to activities at country level and must respond proportionately to need, allowing their allocations to be co-ordinated at both global and country levels. The UN must be supported in a strong central co-ordination and regulatory function and a new humanitarian MDG should be agreed.

There may be a case for some UN agencies to withdraw from direct delivery of humanitarian aid – arguments exist for both sides.

### ***Is there a future for the concessional arms of the Regional Banks?***

We argue that there is. The RDBs have legitimacy through their membership and they should be able to articulate and respond to regional issues more flexibly than IDA or the EC. They need to invest seriously in their regional integration and cross-border investment programmes and distinguish themselves more clearly from IDA.

Clearer corporate visions should help drive effectiveness; donors should stop trying to make the RDBs look like IDA.

### ***What is the EC's comparative advantage?***

The benefits from the EC's engagement are dependent on the EC's ability to act as a harmonising force and on its effectiveness. There are virtually no benefits from the EC acting as a 16<sup>th</sup> or 26<sup>th</sup> donor.

If effectiveness and poverty focus can be improved, the EC could be given exclusive competence in aid, i.e. take on the full function of European Member States' bilateral programmes. This would give the EC enormous political weight within the international system. However, EC budgetary limits might act as a cap on the total size of the aid programme, in which case it would be unlikely that the EC could take on more than 50% of member states' programmes.

Alternatively, an effective EC could provide an aid-management service for the smaller countries in the European Union (EU) and take on full responsibility for co-ordinating or even pooling the major EU bilaterals in-country (either through the Budget or through an enlarged European Development Fund [EDF]), as well as ensuring policy coherence between the EC's internal and external policies. Poor countries already have strong expectations of harmonisation by EU member states.

Or, finally we could envisage a Commission which does not have an aid budget but which ensures harmonisation at the country and policy levels. Maybe the size of the EC aid programme does not matter? If European donors finance IDA instead, we could then imagine

a much stronger and more co-ordinated European voice in IDA. Without an aid-programme the EC might be more outward looking and more able to play a high-profile strategic role.

### ***The UN development system?***

The UN should be making a substantial contribution to the management of globalisation. This should include tackling social, legal, cultural and political issues, which are not within the competence of the Bretton Woods Institutions (BWIs). The UN should also continue to offer sound global economic challenges to the BWIs through high quality evidenced-based policy analysis. It should also continue to play a key role in failed states, including the provision of transitional governance arrangements.

Donors must change the way the UN is financed, by refocusing on the core and matching finance to assessments of the essential size of that core. There is a case for introducing replenishment type financing models but these must learn from mistakes with the MDB approaches. There is no urgent need to force mergers or structural reform. The emphasis should be on making sure that individual UN agencies in-country are doing what governments want them to.

But UN agencies should not only deliver their core 'policy' roles. They should also retain capacity for some limited and focused operational and service functions; including agency functions for government. These should be carried out transparently, through country-based financing mechanisms and by responding to country demands.

### ***Can we really create an effective system that is accountable and responsive to the poorest countries?***

Current accountability is so weak it should not be hard to make progress. We argue for a legitimate challenge role for the UN, for stronger regional roles for the RDBs and to increase borrowing country voice in IDA and RDB replenishment processes. The Cotonou agreement already has strong voice and power-sharing built in. However, throughout the system we will only see a change in accountability and voice if bilateral programmes cease to dominate.

We do not believe that there is a long-term trade-off between increasing voice and effectiveness. All member states and shareholders must take their corporate governance responsibilities seriously and in many cases far more work is needed to achieve this. But for the same reasons that we supported empowering countries to set their own policy agendas through Poverty Reduction Strategy (PRS) processes, we must enable countries to exert more control over the agencies that they interact with.

There is a missing part of the architecture where global aid issues can be legitimately discussed. In the medium term, the DAC is not the appropriate forum and neither is the Development Committee. Drawing on the recommendations made by Boutros-Boutros Ghali in the mid-1990s, we argue that the UN Economic and Social Council (ECOSOC) needs to be reformed to play this role credibly and effectively. But ECOSOC reform will take time, in the shorter term a reformed role for the Development Committee and greater use of the regional commissions of the UN would add-value.

### ***From vision to strategy?***

We recognise that this paper has taken a narrow perspective on what could be embraced by 'the international development architecture'. It has focussed on the transfer of resources - finance and expertise - to low-income countries, without covering wider issues having an impact on low-income countries, for example the governance of globalisation, managing conflict, security and stability.

The development architecture sits in an environment with an institutional structure and particular political dynamics. Analysis of the political constraints and opportunities to initiating change or reform should inform consideration of which of the paper's proposals to take forward, and the team has commissioned work in this area. But even without further analysis, it is clear that achieving the type of changes recommended in the paper will lead to a re-ordering of relations between the developed and developing states. Persuading other dominant actors of the need for such reform will be difficult. As we decide on the strategy and how to take it forward, we should be aware of the opportunities and threats involved.