

The Role of the International Financial Institutions in the International Aid Architecture

Sarah Mulley, April 2007

Key question: What role do/should the IMF and World Bank play in the international aid architecture?

Background

Aid volumes have been increasing steadily over the last decade. Even excluding debt relief and humanitarian aid, core development aid grew on average 4.6% p.a. in 2001-2004. At the same time, the number of agencies disbursing aid has continued to increase – the average number of donors per recipient country rose from about 12 in the 1960s to over 33 in 2001-2005. There are now over 90 official aid agencies (bilateral and multilateral), and donors fund over 60,000 aid projects and programmes. Around 70% of aid is delivered by bilateral agencies (like DFID), with the remainder channelled via multilateral institutions.

The nature of aid is also changing – more is being delivered in support of government programmes via budget support or sectoral programmes, more is being allocated to the social sectors (health, education etc) and governance has emerged as a key concern of donors.

Donors, recipients and civil society are increasingly concerned with aid effectiveness. In 2005 over 100 donors and recipients signed the *Paris Declaration on Aid Effectiveness*. The Declaration includes 56 'partnership commitments' and 12 agreed targets for progress by 2010. These commitments are based on five principles:

- Ownership – recipient countries set their own development strategies and manage their own resources.
- Alignment – donors base their aid on countries' own strategies and institutions.
- Harmonisation – donors work together to improve their collective effectiveness.
- Managing for Results – aid is managed in ways which focus on development results.
- Mutual Accountability – donors and recipients are accountable to each other, and to citizens, for results.

Donors have pledged even more significant increases in aid in the future – if these pledges are met, aid will reach \$130bn a year by 2010. Aid will also be coming from different donors – around two thirds is expected to come from Europe by 2010, and new donors (both official e.g. China, and private e.g. Gates Foundation) will rise in importance. If the Paris agenda is implemented, aid should become more country-led, with an increasing amount channelled through recipient governments.

Where do the IFIs fit?

The IFIs, particularly the World Bank (IDA) play a very important role in the aid system. IDA, while no longer the largest multilateral donor (now the EC) disbursed over \$8.5bn in concessional finance in 2005. The IMF, while disbursing much less concessional finance (less than \$1bn) often acts as a 'gatekeeper' for other aid flows.

The World Bank in particular has been a key player in the Paris agenda, and in some countries is now acting as de facto coordinator of other donors. The World Bank has a number of features which ensure that it retains an influential position in the aid system:

- Resources - although IDA has now been overtaken by the EC in terms of absolute levels of disbursements it remains very important in the countries where it works, accounting for a growing share of aid to IDA-eligible countries. If it retains its share of donors funds we can expect significant increases up to 2015 as aid volumes increase.
- Coverage – IDA operates in almost all low income countries;
- Capacity – the Bank has much greater capacity for analysis and research than many other donors;

- Flexibility of funds – IDA funds are, for the most part, not earmarked for any particular sector. The World Bank is also less vulnerable to the particular interests and priorities of individual donors, which frees it up to engage with processes like the Paris agenda.

All this raises the question of where the IFIs, and the World Bank/IDA in particular, will fit in the aid architecture in the future – this question has been identified as a ‘special theme’ in the IDA 15 negotiations.

2020 Scenarios

It is useful to think about different scenarios for the future role of the IFIs, and the World Bank in particular, in the aid system. We need to think about what role the IFIs should be playing to ensure that aid delivers for poor people in future; and what reforms will be needed now to make sure that the IFIs are ready for this role.

The Decline of the IFIs

New donors, without significant influence over the IFIs’ governance, have not engaged with the institutions. China, India and others have become major players in the aid system, but are choosing to deliver almost all their aid bilaterally, which gives them the flexibility to pursue their own economic and strategic priorities. Meanwhile, the traditional donors have also disengaged – European donors are putting most of their multilateral aid into the EC and the newly reformed UN system and the USA is giving most of its aid bilaterally. IDA continues to operate, but its resources are increasingly dwarfed by other financial flows. The IMF no longer provides concessional finance to low income countries.

A Specialised IDA

The Paris agenda has evolved into a process of rationalisation among donors. Donors have agreed a division of labour whereby no more than 5 or 6 work in any given country, and each has also developed sectoral specialisms. IDA has emerged as the lead donor for economic and governance reform, and has developed unrivalled expertise in this area which means that other donors follow its lead in this policy area. It has its largest presence in countries emerging from economic and political crisis, and now only has a significant presence on the ground in 20-30 countries.

IDA as Lead Donor

Donors increasingly work together at country level, and IDA’s resources and reach have ensured that it is a lead donor in most countries. Along with the EC and some of the larger bilaterals (including DFID) the World Bank sets the agenda for aid at the country level. Many other agencies do not have country offices, relying on the Bank and other donors to deliver projects and programmes on their behalf.

A New Multilateralism

Massive increases in aid volumes in the years to 2015 and increasing concerns about donors coordination meant that donors channelled increasing levels of resources via the IFIs. IDA, in particular, has expanded and now disburses over \$50bn a year, making it the largest donor agency. New donors are also channelling significant resources through IDA, encouraged by reforms to governance which have given them more influence in the institution. IDA continues to work across almost all low income countries, and across all sectors. Although IDA is now more accountable to poor countries than it used to be, concerns remain that it continues to promote a ‘one size fits’ all model of development.

Questions to Consider

- What are the IFIs’ strengths and weaknesses as aid agencies?
- What role should they play at the international level?
- What role should they play at the country level?
- What reforms are necessary now if the IFIs are to make a positive contribution to the emerging aid architecture?
- How should the UK be engaging with the IFIs to secure these reforms?