



Report

Five steps to smarter multi-bi aid

A new way forward for
earmarked finance

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April 2017

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Cover photo: A is for Abacus by Mathieu Jarry.

Acknowledgements

The author would like to thank Nilima Gulrajani for suggesting the idea for this paper and providing helpful comments. Mikaela Gavas and Piera Tortora provided additional comments. The generous financial support of the Bill and Melinda Gates Foundation is acknowledged in making this research possible.

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Abstract

Multi-bi aid – donor contributions to multilateral organisations earmarked for specific purposes – is an important channel for financing development, and is expected to grow. Yet multi-bi aid poses significant challenges for both multilateral and bilateral actors, including lack of alignment with recipient-country priorities, aid fragmentation, and increased transaction costs. This paper explores the potential for smart reforms of multi-bi aid. A five-step plan to improve multi-bi aid calls for better data-access and management; recovering the full economic cost of earmarking; fee structures for improving impact; stronger internal rules to curb fragmentation; and better country ownership and participation. These reforms can make multi-bi aid more effective and efficient while enhancing its legitimacy in the eyes of recipients.

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1. Introduction

Over the past two decades, ‘multi-bi aid’ has become a significant feature of the global aid architecture. This new type of foreign aid¹ refers to donor contributions to multilateral organisations earmarked for specific development purposes, including regions, countries, themes, or sectors (Organisation for Economic Co-operation and Development (OECD), 2011: 28). Following tremendous growth over the past 15 years, multi-bi aid reached a volume of US\$27 billion in 2015, which represents about 15% of total aid (see section 2). For many multilateral agencies, especially the United Nations (UN), multi-bi aid has long outgrown core contributions and hence constitutes the primary funding channel for development. In 2015, the UN financed about 77% of its operational activities for development through earmarked contributions. Almost 90% of these earmarked resources supported individual projects rather than broad thematic priorities, implying that about 66% of all resources for development are strictly earmarked according to donor priorities (UN, 2016: 10).

Earmarked multilateral finance is growing in popularity for several reasons. At one level, gaps and inadequacies in the multilateral system propel its use. Donors often deploy multi-bi aid to circumvent sluggish decision-making procedures. Multi-bi aid can therefore enable multilateral activity that is otherwise precluded due to institutional limitations and restrictive mandates (Weaver, 2008; Morrison, 2013; Eichenauer and Reinsberg, 2017). For example, trust funds allow the World Bank to engage in post-conflict spaces where its Articles of Agreement would otherwise not permit.

Donors have also established multilateral funds to exert greater leverage over policy. For example, donors used the Global Fund to fight AIDS, Tuberculosis and Malaria to redirect policy priorities at the World Health Organization (WHO) towards these three diseases (Sridhar and Woods, 2013). Perceived inefficiencies of the traditional multilaterals drove the creation of vertical global funds outside the established multilaterals (Isenman and Shakow, 2010: 12). For bilateral donors, trust funds may be convenient because they can count aid flows as fully disbursed even when these flows are not yet disbursing on specific activities (Eichenauer, 2017).

Donors have idiosyncratic reasons for using multi-bi aid channels. Multi-bi aid can be especially helpful for smaller donors keen to expand their influence in areas where they have limited capacity (Michaelowa et al., 2016). Limited public support for foreign aid may also incentivise the use of multi-bi aid; its use can demonstrate control over aid spending while sharing financial burdens with other donors. Moreover, all donors have constituencies that care about specific recipients, sectors or themes, and multi-bi aid can satisfy these demands by increasing the visibility of multilateral giving. It may also offer an easy way to demonstrate accountability demanded by domestic audit institutions and national parliaments.

Multi-bi aid has flourished in many cases because of policy entrepreneurs inside multilaterals (and bilateral donor administrations). Multi-bi aid empowers individual actors in aid bureaucracies, particularly operational units striving for budgetary power, autonomy and prestige (Dreher and Lang, 2016). The initiative to establish a trust fund rarely comes from agency leadership or bilateral donor governments. Instead, country units are usually instrumental, especially in the case of country-specific funds (Reinsberg, 2017a). For operational staff, earmarking is not generally perceived as a problem because they obtain supplemental resources that are closely aligned with their ongoing activities (Jenks and Topping, 2016: 14). And yet the negative consequences of scattered activities can be felt disproportionately by upper management, who lack knowledge of initiatives and lose flexibility as a result.

Ambitious donors can be expected to expand their use of multi-bi aid within like-minded coalitions (Eichenauer and Hug, 2015; Graham, 2015, 2016; Reinsberg, 2017b). Multi-bi aid however creates new challenges that relate to effectiveness, efficiency and legitimacy. Specific reforms could enhance its quality and impact. This paper provides an overview of key definitions relating to multi-bi aid, outlines the challenges it presents, and offers five proposals for its improvement in the future.

1 In this paper, ‘foreign aid’ refers to official development assistance (ODA).

2. What is multi-bi aid?

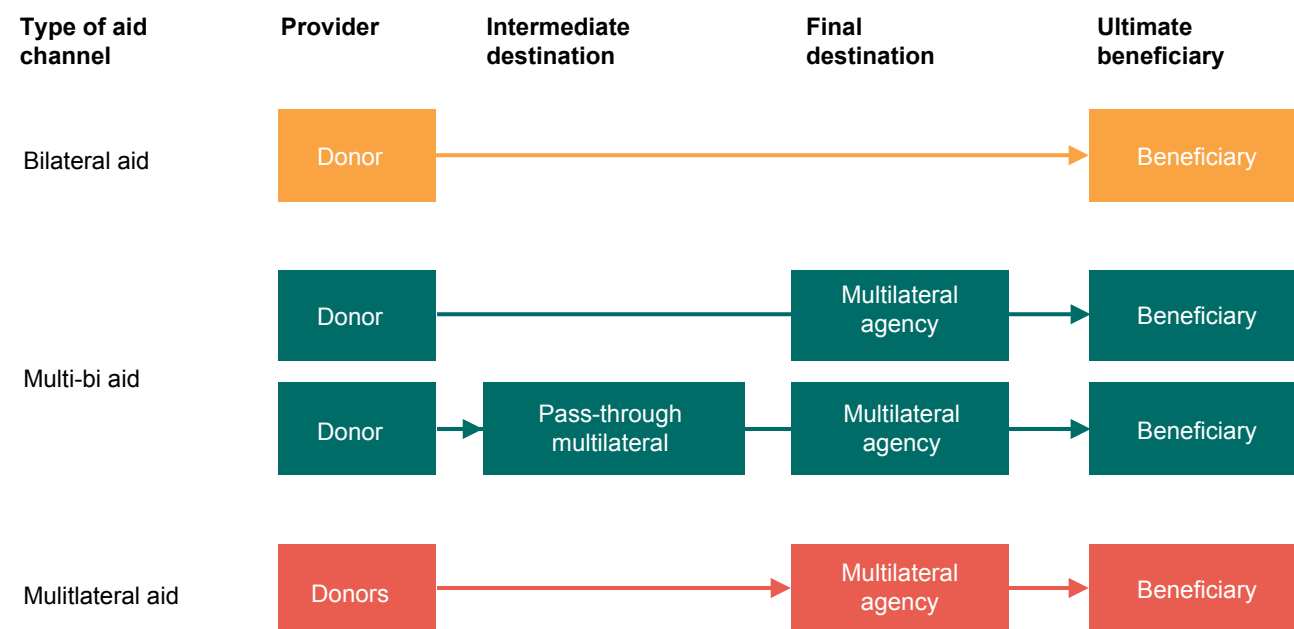
Multi-bi aid can be defined as donor contributions to multilateral organisations that are earmarked for specific development purposes. In contrast, multilateral aid refers to all unearmarked contributions to multilateral organisations, which includes membership fees and voluntary contributions. The distinctive feature of multi-bi aid is that funding is pre-determined by the donor(s) to be used only for specific purposes, for example (sub-) regions, countries, sectors, or themes (OECD, 2011: 28). Multi-bi aid is also known as ‘non-core resources’ as it is not pooled with other resources that are under the purview of the formal governing bodies (UN, 2012a). With bilateral aid, a donor transfers aid resources directly to an intended beneficiary without intermediating the funds through a multilateral organisation (Figure 1). By using multi-bi aid, bilateral donor countries can harness the implementing capacity and the specific expertise of multilateral agencies.

2.1. Who provides multi-bi aid?

Multi-bi aid originates from two sources (Figure 1). The first source is **bilateral donors** channelling earmarked contributions to trust funds hosted at traditional multilateral organisations. Bilateral donors are not unitary actors and as such, multi-bi aid allocations can be made from various government departments, which otherwise do not formulate development policy, for example ministries of education, energy, the environment, health, or labour.

A second source of multi-bi aid resources are ‘**pass-through multilaterals**’ – legally independent multilateral institutions that operate in specific (sub-)sectors such as health, education, and the environment. Though their aid receipts from bilateral donors qualify as multilateral aid, their outflows are counted as multi-bi aid because they specify distinct (sub-)sectors for spending. Most pass-through multilaterals exist as global funds and rely on

Figure 1. Overview of ODA channels



Source: Reinsberg et al. (2015).

2 Multilateral agencies are not the only potential implementers of global-fund programmes, but the typical grant involves a partnership between a recipient government and a multilateral entity (with possible involvement of local non-government partners).

traditional multilaterals for implementing programmes at the country level.² For example, the Global Fund to Fight Aids, Tuberculosis, and Malaria has become the WHO's most important donor but only provides resources to

address three global diseases (Sridhar and Woods, 2013). Accounting for pass-through multilaterals in the ODA statistics presents a considerable challenge (see Box 1).

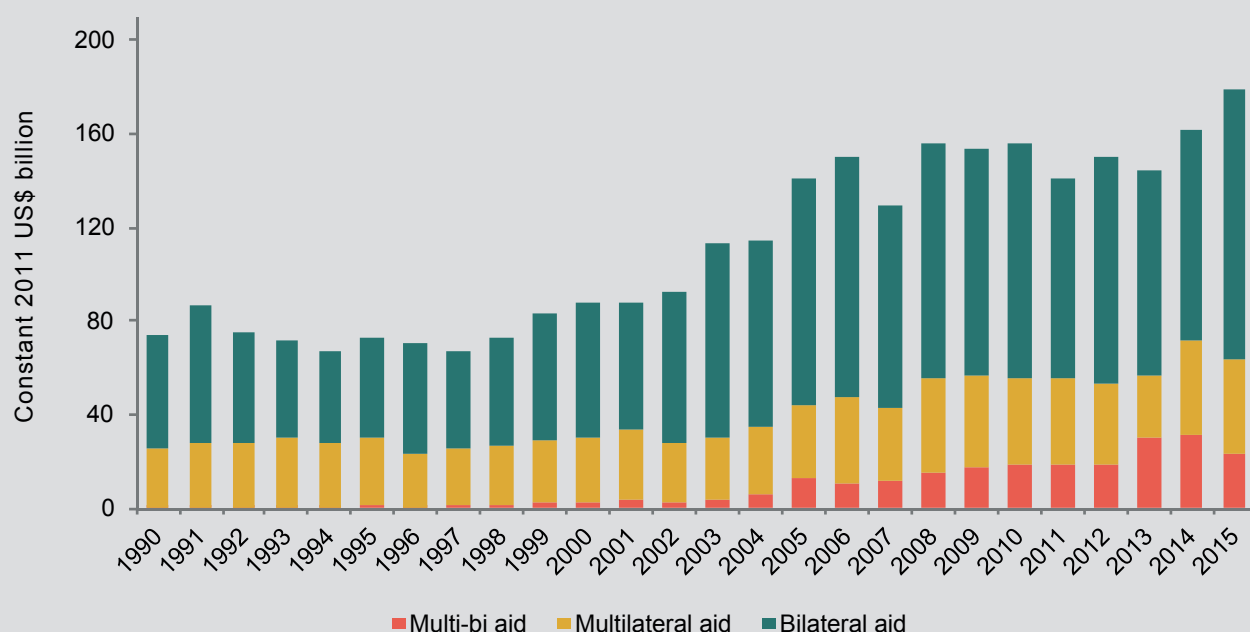
Box 1. Tracing the flows of multi-bi aid in the multilateral system

Two possible treatments of pass-through multilaterals generate discrepancies in ODA statistics. From a bilateral donor perspective, contributions to pass-through multilaterals are unearmarked and therefore counted as multilateral aid. To avoid double counting, pass-through multilateral outflows must be dropped from the count, implying that multi-bi aid includes only formally earmarked contributions by donor countries. This conventional accounting approach underestimates the importance of multi-bi aid. According to OECD Development Assistance Committee (DAC) figures, multilateral aid amounted to US\$41 billion in 2013, compared to US\$18 billion in multi-bi aid (OECD, 2015: 2).

From a multilateral agency perspective, receipts from pass-through multilaterals are often tightly earmarked to particular projects (UN, 2016: 14). For this reason, classifying resource flows involving pass-through multilaterals as multilateral aid may be misleading. To improve multi-bi aid, it is essential to capture the full scope of multi-bi aid.

Tracking the flows of multi-bi aid over the past two decades has become possible recently with new multi-bi aid data (Eichenauer and Reinsberg, 2017).³ This multi-bi aid dataset is based on the Creditor Reporting System (provided by the OECD/DAC) and tracks multi-bi aid activities of all donors. In addition, it includes information on the intensity of earmarking from the perspective of the receiving multilateral organisation (Eichenauer and Reinsberg, 2014). Offering a different way of accounting for multi-bi flows, this dataset results in higher estimates of multi-bi aid than OECD data; specifically, multi-bi aid was estimated to be US\$27 billion in 2013 (Figure 2), compared to about US\$19 billion according to OECD/DAC data.⁴

Figure 2: Evolution of multi-bi aid



Notes: data from 1990 to 2012 from the multi-bi aid data (Eichenauer and Reinsberg, 2017), for subsequent years from OECD/DAC statistics,⁵ with accounting of pass-through multilaterals.

3 The data are freely available at <http://www.ipz.uzh.ch/de/forschung/lehrstuehle/ep/research/internationaldevelopment/multi-bi-aid.html>

4 The sums of both figures in both perspectives should be equal but discrepancies are due to different base years of the deflated series.

5 Available at stats.oecd.org (Accessed January 11, 2017)

2.2. Purposes of multi-bi aid

Multi-bi aid allows donors to specify their priority areas of development cooperation while harnessing the global expertise and implementing capacities of multilateral agencies. Recent research has made it possible to trace earmarking patterns from the perspective of multilateral agencies. Earmarking has at least two independent dimensions: geography and theme. For example, bilateral donors tightly earmark their contributions by country, restricting funds to a single country even when the receiving organisation has a global mandate (Eichenauer and Reinsberg, 2017). If earmarked for specific countries, multi-bi aid targets middle-income countries more often than traditional aid flows (Reinsberg et al., 2015). This is because in many organisations, core funding has become increasingly poverty-selective, leaving funding gaps in more middle-income countries that are being filled by earmarked finance. Furthermore, most activities can be earmarked thematically, restricting the use of funds to specific sectors such as post-conflict reconstruction and humanitarian assistance. Double-earmarking – by country and theme – is also possible.

Donors also predominantly use **Single-Donor Trust Funds** (SDTFs, earmarked funds supported by only one donor) rather than **Multi-Donor Trust Funds** (MDTFs, earmarked (programmatic) funds supported by several donors). SDTFs accounted for more than 70% of multi-bi aid between 2006 and 2012 (Reinsberg et al., 2015: 540). While there are a few countries in which multi-bi aid is the primary aid channel, bilateral donors tend to give multi-bi aid to countries where they are already present bilaterally.⁶

2.3. The variety of multi-bi aid arrangements

Multi-bi aid arrangements are negotiated between the donor(s) and the multilateral trustee and laid down in an administrative agreement. Donor contributions based on such agreements are channelled into a ‘trust fund’. From a legal point of view, **trust funds** are financial instruments for development grants managed by a trustee, typically a multilateral organisation, with the requirement that these assets must be kept separate from core funds and follow specific reporting requirements tailored to donor needs (Drosesse, 2011: 113). These trust funds are established under the institutional law of the host multilateral agency and thus are not independent of their host. This feature marks a key difference from pass-through multilaterals, which do have the ability to enter into legal contracts independently.

Trust funds are extremely flexible devices that can accommodate a variety of governance arrangements and funding purposes. Different agencies use different governance models. At the World Bank, the simplest possible trust fund is a **co-financing arrangement** by which a donor provides additional resources to an existing project (if no project previously existed, this would be a **free-standing fund**).⁷ In contrast, **programmatic funds** first collect donor contributions and disburse the funds at a later stage according to predefined programmatic priorities. Programmatic funds are most commonly organised as MDTFs and provide more flexibility for multilaterals. They require a more complex governance structure, which includes a governing board that sets overall priorities, a

Table 1. Multi-bi funding arrangements at different agencies

	Project-specific funding	Programmatic funds / pooled funds	
United Nations	E.g. United Nations Conference on Trade and Development (UNCTAD) project for Promoting Responsible Sovereign Lending and Borrowing	<ul style="list-style-type: none"> Thematic funds (e.g. UNDP Crisis Prevention and Recovery Thematic Trust Fund) Country-specific funds (e.g. UNDP Law and Order Trust Fund for Afghanistan) 	<ul style="list-style-type: none"> Global pooled funds (e.g. Peacebuilding Fund) Country-specific pooled funds (e.g. One UN Fund⁸ for Malawi)
World Bank	<ul style="list-style-type: none"> Co-financing (e.g. addressing gender-based violence in South Kivu) Free-standing fund (e.g. Japan/WB Global Development Awards) 	Country-specific funds (e.g. Afghanistan Reconstruction Trust Fund)	Programmatic funds with several regional units as implementers (e.g. Forest Carbon Partnership Fund[s])

Source: IEG, 2011; UN, 2016; Jenks and Topping, 2016.

⁶ According to OECD/DAC analysis, donors invest multi-bi aid in sectors that are different from their bilateral investments (OECD, 2015: 10).

⁷ This distinction makes sense only in the World Bank context, where typical projects are loans, not grants, and co-financing allows donors to support some elements of loan projects through trust-fund grants (Reinsberg, 2017a).

⁸ One UN Funds are specific multi-donor trust funds that receive strong support from recipient countries due to a consultative process throughout the programme cycle (OECD, 2015: 15).

technical review committee that assesses the suitability of funding proposals, and a trust-fund secretariat to manage the day-to-day business and coordinate the stakeholders (Herrmann et al., 2014: 7). Trust funds can provide programme resources that support individual country and global thematic activities, as well as analytical work and technical assistance by multilateral agency staff themselves (Independent Evaluation Group (IEG), 2011: 9). To cover overhead costs, or ‘non-programme resources’, the trustee deducts a management fee.

The UN distinguishes three types of multi-bi aid resources it receives. First, **project-specific funds** are most tightly earmarked and represent the lion’s share of earmarked resources. Second, **single-agency pooled funds**, which often support specific development themes. While managed by a single UN agency, these funds receive

contributions from multiple donors. They are softly earmarked as the UN agency itself makes fund-allocation decisions to specific projects within the overall programme. Third, **inter-agency pooled funds** are multi-entity funds to support global priorities (for example peace-building) and country-specific programmes (for example the Central African Republic Transition Fund). Donors cannot earmark contributions to specific entities. It is often the United Nations Development Programme (UNDP) that administrates inter-agency pooled funds through its Multi-Partner Trust Fund Office (Downs, 2011). In the standard arrangement, implementing agencies receive 7% to cover overhead costs and fund administrators retain a small fraction to cover the costs of secretariat services (Jenks and Topping, 2016).⁹

⁹ Examples include the Central Emergency Response Fund (CERF) – a global humanitarian fund managed by a central secretariat – and country-specific Common Humanitarian Funds, in which the UN Humanitarian Coordinator makes final allocation decisions.

3. What are the problems with multi-bi aid?

Multi-bi aid has the potential to make important contributions to development, and has in many cases already expanded the resource base for global public goods, fragile states, and humanitarian assistance (IEG, 2011). However, it has also given rise to a number of challenges, four of which are outlined below.

3.1. Transaction costs

Bilateral donors achieve flexibility from multi-bi channels at the expense of multilateral agencies. Transaction costs arise from the preparation, negotiation, implementation and enforcement of multi-bi agreements for the delivery of ODA (Lawson, 2009). For example, trust funds at the World Bank are funded by more than 220 donors including sovereign donors, multilateral donors, philanthropic foundations, companies and international non-governmental organisations (INGOs) (Reinsberg, 2016). Some donors require special accountability provisions for contributions to ensure domestic compliance. These exigencies increase administrative burdens on agency staff and, coupled with the demands of fundraising, can dilute the focus of their work (The 1818 Society, 2012).

The sheer number of trust funds implies a multiplication of decision-making venues that increases administrative costs while also straining the capacity of bilateral donors. Trust funds have also failed to deliver on their promise to reduce aid fragmentation for recipient countries (Barakat, 2009: 108; Woods, 2005: 394; Barakat et al., 2012: 2). This is because donors do not tend to phase out their bilateral programmes when they participate in multi-donor trust funds (Barakat, 2009: 112).

Trust funds are transaction-heavy over their entire lifetime. Upon creation, every trust fund requires negotiating an administrative agreement with the trustee, and bilateral donors need to coordinate policy priorities once funds are operational. While trust funds may appear convenient for bilateral aid officials who need to meet spending targets, money can sit in the fund and not get disbursed, as some suggest UK funds do in the World Bank (Mostrous and Kenber, 2016). This makes trust funds a rather expensive tool to scale up development aid because

the World Bank deducts management fees on contributions (rather than disbursements).

3.2. Policy incoherence

The explosion of donor-funded earmarking makes it difficult for agencies to formulate coherent development strategies around which to build donor support. Vested interests inside multilateral agencies carry the risk of making the entire organisation unmanageable. For example, as the World Bank management aims to standardise trust-fund procedures in order to curb fragmentation, operational units fret about a loss of flexibility.

The proliferation of multi-bi aid activities also poses challenges for bilateral donors. In most donor countries, multi-bi aid-allocation decisions are scattered across various departments and field offices, and governments often lack a comprehensive view of engagements with a single multilateral (OECD, 2015: 10). Even where such information is available, ensuring policy coherence is difficult because relationships are dispersed across diverse ministries.

3.3. Harmful competition

Multi-bi aid spurs competition among different agencies (Reinsberg, 2016). While ‘mild competition’ may promote efficiency, harmful competition diverts attention from recipient-country needs and prevents system-wide coordination (Mahn, 2012; UN, 2012a; Tortora and Steensen, 2014). The UN system features considerable levels of competition for multi-bi funding. UN agencies compete most fiercely in the health and humanitarian sectors, as well as in the multi-agency UN Peacebuilding Fund and the UN Trust Fund (UN, 2012b: 50). According to a UN country survey,¹⁰ the main effects of competition are confusion for the government, increased workload, and diversion of UN staff attention (UN, 2012b: 50-55).

Increased competition can also undermine the financial health of multilateral agencies. Having lowered management fees to attract new funding, some agencies

¹⁰ The UN Secretariat conducted two surveys with UN field officials (UN, 2013) and recipient governments (UN, 2012b), with the aim of enhancing the development contribution of the UN on the ground.

charge fees that are insufficient to cover programme support costs. This problem is particularly acute when earmarked resources outgrow core resources. As a result, several UN entities revised their fee structures upwards in 2013, although an independent assessment concluded these rates were not consistently applied (UN, 2016: 19).

3.4. Politicisation of multilateral institutions

Multi-bi aid paves the way for undue influence by individual donors. At the World Bank, trust funds almost never require approval by the Board of Executive Directors, while at the UN, governing boards may simply ‘take note’ of non-core programmes. A significant portion of operational activities of multilateral agencies thus lies beyond the control of governing bodies. This raises the

question of legitimacy of multilateral governance – a critical issue especially for multilateral organisations meant to represent the neutral global interest. While donor influence is a well-known feature of multilateral governance (Dreher et al., 2009; Stone, 2011; Kilby, 2013), the sheer size of trust funds in overall programme budgets provides donors with unprecedented levels of control.

By distorting programme priorities toward donor-driven agendas and reinforcing sector priorities over country priorities, multi-bi aid may reduce the legitimacy of multilateral operations in the eyes of recipient countries. While recipient countries partake at least formally in multilateral governance of core resources, they lack influence over non-core resources beyond the purview of formal accountability processes. This is unfortunate as trust funds have always been intended to enhance country ownership and inclusive decision-making.

4. A five-step plan for smarter multi-bi aid

In light of the challenges above, there are five areas where reforms to standing practices may improve the effectiveness, efficiency and legitimacy of multi-bi channels.¹¹

1. Stakeholders should improve data quality, data management, and public access to data to promote smart allocation of multi-bi aid.
2. Multilateral agencies should differentiate fees to recover the full economic cost of earmarking and provide incentives for bilateral donors to invest in the least administratively burdensome multi-bi aid mechanisms. They should also establish a contingency fund for programme support costs, and provide high visibility and results attribution for its donor contributions.
3. Agencies should develop fee structures that provide incentives for multilateral agency staff to improve the impact of multi-bi aid programmes.
4. All stakeholders need to minimise portfolio fragmentation by developing specific administrative rules.
5. Stakeholders should provide greater support for recipient countries to address country-specific priorities and ensure their meaningful participation.

4.1. Strengthen data quality and data management

The paucity of data within bilateral donor agencies about the sources, size and purposes of multi-bi aid compromises the ability of multilateral institutions and bilateral donors to be strategic and internally coherent. The restricted overview of multilateral engagements implies that donors are unaware of inefficiencies in their current allocations, which undermines the principle of supporting only the most efficient multilateral channels. Donors need to increase their awareness of the importance of data transparency and enforce systems to centralise the flow

of information on multilateral engagements (Tortora and Steensen, 2014: 32). Moreover, the incentive structures leading to an increased multilateral proliferation need to be understood better (Senior Level Donor Meeting (SLDM), 2012: 5).

Lack of (access to) data prevents more definitive conclusions regarding system-level reforms. Better data hold the key to evaluating the differential effectiveness of multi-bi aid compared to traditional channels of aid, and provide guidance on more effective aid allocation. For example, the UN entities took a welcome first step by adopting a common standard on reporting on their funding flows (Jenks and Topping, 2016: 22). Moreover, individual agencies have taken steps to integrate budgets in order to increase transparency and promote long-term commitments (Jenks and Topping, 2016: 14). In the future, agencies should collate data at a much more detailed level. This means there should be data for all trust funds and all donors individually and disbursement data for all trust funds at project level. This would provide the basis for thorough analysis on the effectiveness of multi-bi aid and better-informed decision-making by aid donors. One obstacle to data-sharing may be the fear of losing resources if and when the data were to uncover relative performance gaps with respect to other agencies. Donors could address such fears by arguing that better information could boost overall commitments to the multilateral system and hence compensate for individual losses.

Finally, bilateral donors need to meet regularly and share best practices on multi-bi aid through relevant policy coordination mechanisms, for example at the Multilateral Organisation Performance Assessment Network (MOPAN).¹² In this context, donors should also commit the human resources necessary to improve their reporting on multi-bi aid. Data quality is essential for tracking multi-bi aid in the development system. For the same reason, non-DAC ‘cooperation providers’ should be integrated into relevant coordination procedures.

11 These recommendations are most relevant for trust funds yet to be created. For existing trust funds – which hold previously committed flows of multi-bi aid – reforms will require changes to existing legal agreements and extensive bargaining among stakeholders.

12 MOPAN was launched in 2002 as a network of like-minded donor countries for monitoring the performance of multilateral development organisations at the country level. Through joint assessments of these organisations, network members identify strengths and areas for improvement in the multilateral organisations that form the basis for dialogue with these organisations.

4.2. Recovering the full economic cost of earmarking

Earmarking can create high transaction costs that are not fully recovered by management fees. These costs often derive from unaccounted staff time, including maintaining donor relations, monitoring and oversight, and special reporting. Moreover, some types of earmarking are more burdensome than others; in contrast, co-financed funds do not create new governance structures and do not require additional reporting. Differentiated fees and the creation of a contingency fund are two ways for recovering the full costs of earmarking assumed by the multilateral host.

When agencies **differentiate fees** according to administrative burdens, they can nudge donors into less burdensome arrangements. Differentiated fees adhere to the principle of fairness: bilateral donors with specific demands pay more than donors who accept the standard institutional arrangements of multilateral agencies. Although some donors may be willing to pay a high fee as they seek influence through specific types of trust funds, more cost-conscious donors will reconsider their earmarking strategy. Within the UN Secretariat, there are proposals to ensure that all strictly earmarked contributions recover full costs of handling multi-bi aid (UN, 2016: 19). For such a policy to be effective, however, all UN bodies will need to introduce it collectively to avoid undercutting each other. This may make further centralisation of fundraising within the UN system unavoidable (Wennubst and Mahn, 2013).

Another way to recoup costs is to create a **contingency fund** devoted to financing the administrative burdens caused by other earmarked funds. For example, the Policy and Human Resource Development (PHRD) fund was created at the World Bank with support from the Japanese government to invest in solid project preparation and effective programme design. Creating a fund to cover administrative costs is, however, a difficult political sell, and the PHRD was phased out in 2012. Reluctance to support such a fund on the part of bilateral donors can be overcome by ensuring high visibility and attributing concrete results to donor contributions. Needless to say, contributions to a contingency fund would carry low administrative burdens and be fee-exempt.

4.3. Fee structures for improving impact

While differentiated fee schedules alter incentives of bilateral donors for burdening multilateral institutions, fee structures can steer earmarked funds to achieve positive impact. For example, fees can be based on the substantive contribution that a fund makes to the development goals of the agency. For example, the World Bank may place more

value on trust funds that allow it to extend its assistance to issue areas that cannot be reached by core funding. The World Bank also levies different fees for different types of trust funds according to their financial risk. These are all strategies to encourage investment in the kinds of trust funds multilaterals believe will achieve desired outcomes.

In order to ensure that trust-fund managers are incentivised to find suitable projects, fees should be based on disbursements. This is because fees based on contributions create incentives to raise funds rather than disburse them. Fees based on disbursements, however, create incentives to disburse previously received funds.¹³ Deducting fees on disbursements rather than contributions would also mitigate concerns within donor publics about wasting resources through multilateral channels. To counteract pressures to disburse fund resources in order to generate fee income, fees should be payable only against clearly identifiable results. This would create incentives for trust-fund managers to insist on clear goals since they need to induce demand for the fund's resources from implementing units. Managers would also have an incentive to improve quality in order to reach agreed results.

Multilateral agencies could introduce a one-off set-up fee (for instance, currently US\$35,000 at the World Bank in the standard agreement). A fixed set-up fee reduces the incentive for bilateral donors to create a new fund, which both minimises administrative burdens and, more importantly, raises the stakes for bilateral donors that are particularly vested in effective programme design. Higher set-up fees can also compensate multilaterals for postponing fee collection until disbursement has occurred.

4.4. Minimise portfolio fragmentation

Experience shows that trust funds flourish when there is a lack of institutional rules to curb their rapid growth. Therefore, the creation of new funds and their management should follow clear rules that seek to minimise portfolio fragmentation rather than being left to the discretion of individual negotiators. Clear rules – for example regarding which types of donor demands are acceptable to an agency – would also prevent unwarranted donor influence. Such rules should *inter alia* cover the scope of earmarking possibilities, eligible expenditures, and reporting, audit, and evaluation (Herrmann et al., 2014: 17). Both bilateral donor countries and multilateral agencies should institutionalise mechanisms to avoid duplicating existing efforts.

Internal rules that have already helped reduce fragmentation at the World Bank include a minimum contribution threshold (currently at US\$2 million), sunset

13 Currently, fees in the UN system are levied on disbursements; the World Bank deduces fees on each contribution by a donor.

clauses to make trust funds expire after a predefined time, and standardised governance clauses. The World Bank has also managed to phase out dormant funds through intensified donor dialogue. For example, the Bank-Netherlands Partnership Program was phased out in 2012 (financial year), facilitated also by changing political preferences in the Dutch government. Another example of phasing-out occurring was the Belgian Poverty Reduction Program. Both budgetary issues in Belgium and the desire of the World Bank to move away from SDTFs meant the end of the programme. Beyond these measures, donors should adopt rules requiring their officials to review the need for a new initiative (rather than joining an existing one) and the chosen form of multi-bi funding arrangement. Multilateral agencies should periodically consolidate programmes and require their staff to demonstrate support for new programmes from multiple donors to avoid the creation of new SDTFs.

Multilateral agencies need to consider the implications of those internal rules that are purportedly unrelated to earmarked funding but are indirectly consequential for its effectiveness. For example, recent analysis has shown that organisational reform proposals can unleash unwarranted multi-bi fundraising (Reinsberg, 2017a). In addition, staffing policies may be important. The success of multi-bi aid initiatives often hinges on the quality of the personal relationship between officers in the donor bureaucracy and the multilateral agency (Herrmann et al., 2014: 40). This makes quality control harder since good relationships are idiosyncratic and not amenable to systematic policy reforms. Furthermore, where programmes are successful, stakeholders must avoid relocations of staff members involved. In general, stakeholders on either side may need to reduce staff turnover and find ways to institutionalise relationships to avoid the perils of transition.

4.5. Enhancing country ownership and participation

Due to its earmarked nature, multi-bi aid risks neglecting recipient-country ownership as bilateral donors privilege their own priorities. Sector-specific earmarking can neglect country issues and priorities, including the active participation of recipient countries in trust-fund design and oversight. It would be better if recipients had vested interests in the success of multi-bi aid initiatives, which could be promoted by increasing local contributions to these initiatives. Evidence from UN country surveys shows

that multi-bi aid may need local conditions conducive to facilitating development impact. For example, the UN's Delivering-as-One¹⁴ initiative created such conditions by removing pressures for fundraising and operating well-staffed resident coordinator offices that facilitated the management of joint funding mechanisms (UN, 2012b: 55).

Efforts to enhance country ownership and to build support for countries to participate in multi-bi aid initiatives are more successful when donors commit to use MDTFs rather than SDTFs. Multilateral agencies can help promote MDTFs by suggesting how donors might consolidate their activities, as well as ensuring more productive political relations between donors and host governments (Muchadenyika, 2016). Most donors are ready to increase their share of MDTFs, with UN officials in the field projecting a moderately higher availability of pooled funding from donors in the future. In addition, MDTFs allow bilateral donors to coordinate their multi-bi aid contributions to reinforce multilateral hubs of expertise at country level. They could accelerate the withdrawal of less efficient multilaterals from the multi-bi aid market and reduce duplication. Recent academic research suggests this may already be happening, as bilateral donors seem more willing to delegate aid multilaterally in country contexts where a multilateral agency has established a country office with a significant project portfolio (Michaelowa et al., 2016).

All the above recommendations can help address the key challenges of multi-bi aid (Table 2). In the first place, stakeholders should improve data management internally by centralising the flow of information, and subsequently promote public access to detailed data to facilitate smart allocation of multi-bi aid. Moreover, stakeholders should seek to recover the full economic costs of earmarked funds, either by differentiating fees or establishing a contingency fund for programme support costs. Ensuring fee structures that support desired development outcomes is also critical. Furthermore, all stakeholders need to minimise portfolio fragmentation by developing specific administrative rules, including periodic donor portfolio reviews; phasing out dormant funds; minimum-size requirements; and sunset clauses. Finally, stakeholders should provide greater capacity-building support for recipient countries to ensure meaningful participation. Stakeholders should strengthen country-specific funds as a key institutional mechanism, and improve dialogue with governments to address country-specific priorities.

¹⁴ This initiative sets out to consolidate all UN efforts at the country level into one UN fund, following the principle of one leader, one budget, one programme and one office, with the implied benefit of greater coherence, reduced fragmentation, and greater country-ownership. So far, eight countries volunteered to be pilots for the initiative (OECD, 2015: 15).

Table 2. Current challenges and proposals for reform

Reform proposal	Policy challenge	Possible causes	Detailed recommendations
Strengthen data quality and data management	<ul style="list-style-type: none"> Fragmented multi-bi aid portfolios Lack of evidence-based allocation 	<ul style="list-style-type: none"> Lack of awareness and lack of managerial oversight Reluctance to share data Vested interests in agencies 	<ul style="list-style-type: none"> Bilateral donors should centralise the flow of information and coordinate with others through MOPAN Agencies need to publicise detailed (harmonised) data to promote research on effectiveness
Recovering the full economic cost of earmarking	<ul style="list-style-type: none"> Strict earmarking Insufficient cost recovery 	<ul style="list-style-type: none"> Specific interests Accountability requirements Need for visibility by donor countries 	<ul style="list-style-type: none"> Differentiated fees to incentivise funds that are less earmarked and less burdensome Contingency fund for programme support costs (provided high visibility and results attribution)
Fee structures for improving impact	<ul style="list-style-type: none"> Dormant funds High transaction costs 	<ul style="list-style-type: none"> Skewed incentives to raise new funds (rather than managing existing ones well) 	<ul style="list-style-type: none"> Fee modalities that combine set-up fees with proportional fees (deducted on actual disbursements and based on results)
Minimise portfolio fragmentation	<ul style="list-style-type: none"> Fragmentation Undue donor demands 	<ul style="list-style-type: none"> Lack of rules and managerial oversight Organisational reforms pertaining to budgets and staffing 	<ul style="list-style-type: none"> Intensify donor dialogue Internal portfolio reviews Reduction of staff turnover Institutionalise successful multi-bi aid partnerships
Enhance country ownership and participation	<ul style="list-style-type: none"> Multi-bi aid programmes not priority for recipients Poor political relations with country governments 	<ul style="list-style-type: none"> Headquarter-driven focus on global themes and pressures for consolidation 	<ul style="list-style-type: none"> Maintain country-specific funds Encourage co-financing (including recipients) Intensify donor dialogue with host government

5. Conclusion: a five-step plan for multi-bi aid

Multi-bi aid is an established channel for bilateral donors to allocate their development assistance to the multilateral system, but it is not without its weaknesses. Careful thought needs to be given to the use of earmarking, as opposed to traditional conduits of (core) multilateral and bilateral aid (UN, 2012a; Tortora and Steensen, 2014; Gulrajani, 2016). The significance of multi-bi aid as a vehicle for channelling resources to multilateral institutions is growing. As a result, smart reforms are needed that harness the advantages of multi-bi aid without straining the capacities of receiving institutions and ultimate beneficiaries.

This paper has advanced five proposals to improve multi-bi aid, which complement existing calls for more strategic use of aid delivery channels. Where donors provide earmarked funding, they should endeavour to offer more predictable financing, yield better results than core finance would, and ensure greater ownership by recipient countries, while also adopting organisational practices that allow for more effective and efficient use of multi-bi aid. Taken together, the proposed measures will help make

multi-bi aid more effective. There could be no better time for stakeholders to act on such an agenda.

Certainly, implementing these reforms will face obstacles. And yet, these reforms may stand a higher chance of being implemented given that current proposals tend to ignore the political realities of most donor countries. For example, the current strategy pursued by the UN system urging donors to reduce earmarked aid and increase unearmarked aid is not enough. Unless bilateral donors are incentivised to reduce earmarking, they will not do so. Such incentives can be monetary – no fees for quasi-core funding for example – but they can also be non-monetary, such as praising donors that help multilateral agencies maintain funding flexibility and showing taxpayers the achievements made possible through their funding. Communicating the true cost of earmarking to an interested public could also help build new support for better-quality funding of multilateral agencies – a joint effort in which both multilateral host and bilateral agencies must engage.

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Annotated bibliography

Barakat, S. (2009) 'The failed promise of multi-donor trust funds: aid financing as an impediment to effective state-building in post-conflict contexts', *Policy Studies*, 30(2), 107-126.

This paper compares the multi-donor fund approach with its traditional alternative, particularly in the context of post-conflict settings. The key point of the paper is that the theoretical benefits of MDTFs have been lost during implementation. Trust funds close down too rapidly (before long-term results are actually achieved), national ownership remains elusive, and funds do not solve the challenge of fragmentation. While joint trust funds hosted by multilaterals appeared to be the ideal instrument to support a common cause by a group of donors, these funds do not remove the donors' incentives to continue their bilateral activities, so that the new trust funds only constitute additional donors on top of the existing ones.

Barakat, S., Rzeszut, K. and Martin, N. (2012) 'What is the track record of multi-donor trust funds in improving aid effectiveness'. DFID and EPPI-Centre, University of London.

This study commissioned by DFID seeks to systematically assess the impact of MDTFs on aid effectiveness. It finds that MDTFs overall have a positive impact on ownership but donors still use earmarking. Results are inconclusive as regards impact on alignment, harmonisation, managing for results, and mutual accountability.

Downs, C. (2011) *Operational effectiveness of the UN MDTF mechanism*. UNDG Evaluation Report, available at <http://mdtf.undp.org/document/download/6916>.

This study, mandated by UN-Development Operations Coordination Office (DOCOC), reviews the effectiveness of the UN MDTF mechanism based on a web-based survey with key stakeholders. The UNDG MDTF model evolved from the UNDG Iraq TF in 2004, but nowadays supports strategic agendas related to the UN Reform to Deliver as One, Humanitarian Reform and Aid Effectiveness. Respondents agree that MDTFs have strengthened coordination among UN organisations, between the UN and governments, and by donors. Overall MDTFs are an effective mechanism to consolidate funding from multiple donors for implementation by multiple UN agencies. However, the gains from unearmarking resources increase the perceived accountability gap for donors.

Eichenauer, V. Z. and Hug, S. (2015) 'The politics of special purpose trust funds'. Unpublished manuscript. Heidelberg: Heidelberg University.

This paper provides a theoretical rationale for the use of multi-bi aid by donors. From a theoretical perspective, the combination of donor preferences, discretion granted to the multilateral organisation, and voting rules influences allocation decisions among bilateral aid, unearmarked voluntary contributions, and earmarked funding. Empirically, the authors provide descriptive evidence that better-evaluated multilateral organisations receive more earmarked and more core contributions.

Eichenauer, V. Z. and Reinsberg, B. (2014) 'Multi-bi aid: tracking the evolution of earmarked funding to international development organizations from 1990 to 2012'. Codebook. Zurich: CIS Working Paper No. 84.

This paper is the codebook for the data introduced in the Eichenauer and Reinsberg (2017) paper on the determinants of multi-bi aid. The data are available at <http://www.ipz.uzh.ch/de/forschung/lehrstuehle/ep/research/internationaldevelopment/multi-bi-aid.html>.

Eichenauer, V. Z. and Reinsberg, B. (2017) 'What determines earmarked funding to international development organizations? Evidence from the new multi-bi aid data', *Review of International Organizations*, doi: 10.1007/s11558-017-9267-2.

This paper introduces the multi-bi aid data and provides the first systematic analysis of underlying determinants. The authors analyse four suggested donor motives for earmarked aid at the donor-recipient level. Contrary to donor claims, they find that earmarked aid and bilateral aid target the same recipients. They also find evidence that some donors use earmarked aid to bypass recipient countries with weak governance.

Graham, E. R. (2015) 'Money and multilateralism: how funding rules constitute IO governance', *International Theory*, 7(1), 162-194.

This paper revisits the conventional academic wisdom regarding the multilateral character of international-organisation (IO) governance by drawing attention to the funding methods used to finance contemporary IOs. While mandatory funding rules are easily reconciled with traditional conceptions of multilateralism, voluntary rules are not. In particular, restricted voluntary funding rules devolve authority over funding decisions to individual actors, undercutting the collective decision-making that is central to multilateral governance. The analysis shows that the UN has transformed from an institution reliant primarily on mandatory contributions to one disproportionately reliant on restricted voluntary funds.

Graham, E. R. (2016) 'The institutional design of funding rules at international organizations: explaining the transformation in financing the United Nations', *European Journal of International Relations*, doi: 10.1177/1354066116648755.

This paper uses original UN funding rule data to demonstrate that not only funding practices but also funding rules have changed over time. It argues that earmarked funding rules are the joint product of divergent preferences regarding the policies and the financial costs of multilateral activities. In contrast, when policy preferences converge but preferences over the multilateral budget diverge, states design voluntary unearmarked funding rules. A longitudinal case study of funding-rule design and change at UN development entities finds support for these hypotheses. The history of UN economic development organisations shows that states with favourable views of the UN sought to expand its activities and introduced funding rules that offered more flexibility and control to donors.

Gulrajani, N. (2016) *Bilateral versus multilateral aid channels: strategic choices for donors*. ODI Report, March 2016.

This report provides guidance to donors with respect to the strategic choice of aid delivery channels. Based on an extensive literature review, it presents four main conclusions: (1) bilateral channels are more politicised than multilateral ones; (2) aid recipients prefer multilateral channels; (3) multilateral channels are less fragmented than bilateral channels; (4) multi-bi aid is not in all cases better than its traditional alternatives – its advantages of greater flexibility for donors come at the cost of greater fragmentation and less legitimacy of multilateral actions.

IEG (2011) *An evaluation of the World Bank's trust fund portfolio: trust fund support for development*. Washington D.C.: IEG.

A landmark study on trust funds from a World Bank perspective, this paper discusses the role of trust funds in the global aid architecture, reviews the different modalities used at the World Bank, assesses the effectiveness of trust-fund support for development based on key structural features, and provides some recommendations on improving management and oversight on trust funds.

Isenman, P. and Shakow, A. (2010) 'Donor schizophrenia and aid effectiveness: the role of global funds'. *IDS Practice Papers*, 2010(5), 01-31.

This paper sets out the constitutive features of the global fund model: evidence-based allocation, scientific review, integrating non-official development actors, focus on outputs (not outcomes), bringing massive short-term change, creating financing agencies rather than implementing agencies, relying on partners, being nimble and adaptable, high transparency, and addressing issues

relating to global public goods. The report then gives advice to donors on how to improve policy coherence of global funds: clarify strategy for multilateral aid and coordinate with other donors on the role of global funds, institutionalise 'thinking twice', use a portfolio approach in allocations, learn from global funds, and give attention to programmes financing ongoing costs.

Michaelowa, K., Reinsberg, B. and Schneider, C. (2016) 'Multi-bi aid in European development assistance: the role of capacity constraints and member state politics', *Development Policy Review*, doi: 10.1111/dpr.12193.

This paper analyses the patterns of multi-bi aid in the European Union. Using newly available multi-bi aid data and a large number of staff interviews at the European Commission, the World Bank and bilateral donors, it finds that (1) the EC's capacity constraints and lack of specific expertise have prevented it from becoming an important host of trust funds like other international development organisations, (2) the same capacity constraints can generally explain its extensive participation in trust funds at other international development organisations, (3) once the EC delegates its aid to multilateral agencies, it does not impose strong substantive earmarking, but requires a high level of legal and administrative controls.

Reinsberg, B., Michaelowa, K. and Eichenauer, V. Z. (2015) 'The proliferation of trust funds and other multi-bi aid', in M. Arvin, and B. Lew, (eds.), *Handbook on the economics of foreign aid*. Northampton: Edward Elgar.

This paper introduces the phenomenon of multi-bi aid. It first traces the historic origins of multi-bi aid in the multilateral system, showing that earmarked funding to international development organisations emerged only after the Cold War. It then discusses its potential challenges based on a literature review. The paper makes use of the new multi-bi aid dataset to present descriptive evidence on the use of multi-bi aid and to assess the scope of some of the challenges. The takeaways are that multi-bi aid can support harmonisation among bilateral donors, mobilise additional donor resources, and complement existing multilateral activities, but it also burdens the multilateral system with additional transaction costs and risks a 'bilateralisation' of multilateral aid. Using simple econometric methods, the authors find no evidence that multi-bi aid is more volatile than other flows at the donor-year level, that it crowds out multilateral aid, or that it responds to economic shocks in the donor countries.

Reinsberg, B., Michaelowa, K. and Knack, S. (2017) Which donors, which funds? The choice of trust funds by bilateral donors at the World Bank. *International Organization* (forthcoming).

These authors study participation decisions by bilateral donors in World Bank trust funds. Theoretically, they argue that individual donors trade off gains from burden-sharing

in funds with more donors against gains in control in funds with less donors. They find support for this argument, given that a given donor chooses a fund with more donors when ex-ante sector preferences among the donors are more aligned, when the thematic issue of the fund has previously garnered consensus at a G8 summit, and when the fund supports global public goods as well as fragile states.

Reinsberg, B. (2017a) 'Organizational reform and the rise of trust funds: lessons from the World Bank', *Review of International Organizations*, doi:10.1007/s11558-017-9268-1.

This paper studies the incentives for trust funds from the perspective of multilateral agencies, notably the World Bank. The paper examines the sudden emergence of 'pass-on funds' (one unit hosts the fund and passes on its resources for implementation to another unit) at the World Bank around the millennium turn. Besides growing availability of donor monies for specific sectors and lenient internal regulation, the analysis suggests organisational reform as the key driver of this trend. In particular, this reform undermined the budget autonomy of the sector units and hence caused these units to seek out new funds

in their relevant areas of expertise. A number of reform features also reduced the administrative budget of the country units. This increased their demand for pass-on funding grants.

Tortora, P. and Steensen, S. (2014) *Making earmarked funding more effective: current practices and a way forward*. Paris: OECD.

The report reviews the different practices toward multi-bi aid on the donor side as well as the agency side. Based on the review of these practices, the paper arrives at four policy recommendations to make multi-bi aid more efficient. First, donors should base their use of earmarked funding on evidence and strategic considerations about when and why earmarked funding may be the most suitable option. Second, donors should provide guidance on the use of earmarked funding with a view to supporting good practices and enhancing internal coherence. Third, when extending earmarked funding, donors should carefully consider the implications of their requests and the conditions they set. Fourth, multilateral organisations should move to transparent and multi-year budget and strategy cycles that integrate all resources and allow transparent reporting and dialogue on results.



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