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Institutional Reforms and the Role of Multilateral Aid Agencies

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Abstract

This paper reviews the role of the multilateral aid agencies in the delivery of aid. The role of these institutions is as old as the debate on the role of aid in economic development. Aid is effective in a good policy environment. However, effective aid delivery is equally crucial. This is why the need to reform the institutions involved in the process of delivering aid is crucial. Among others, the paper concluded that there is a need for redefining the roles and the establishment of a well articulated network among the various institutions involved in the aid process. More importantly, given the different actors and motives at play in the transfer of resources to recipient countries, the role of a supranational institution to coordinate and give direction is indispensable.

Keywords: foreign aid, institutions, development aid

JEL classification: F35, G29

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1 Introduction

There is no longer any doubt about the role of external development financial assistance in the economic performance of recipient countries where such assistance is undertaken in a conducive economic policy environment (World Bank 1998).[1] Development assistance, focusing on investment projects in infrastructure, agriculture, industry and the social sectors, has been found to be very effective in reducing the scourge of poverty by enhancing economic growth particularly in poor nations. However, in recent times, aid flows particularly to developing countries have been weighed down by a number of problems, prominent among which are the limited availability and too much concentration in a few recipient countries. The increasing scarcity of development finance has now become generally accepted as the most critical development problem that many low income countries face. Although foreign direct investment (FDI) flows to developing countries actually witnessed a phenomenal increase in the 1990s, what is evident is that these large private flows are highly concentrated in a few middle-income developing countries.

The fact that domestic resource mobilization is needed for national economic development has never been in doubt. An enabling domestic environment is vital not only in mobilizing domestic resources, but also in attracting and effectively utilizing foreign investment. Good governance, well-managed public finances, a dynamic private sector, access to finance by all segments of the population, including small- and medium-scale enterprises (SMEs), and adequate skills are undeniably components of the domestic resource environment that should foster resource mobilization. However, even when countries have made substantial progress in these institutional and policy areas, the need for external domestic flows to supplement national efforts remains indispensable. Although many low-income countries have begun to improve domestic resource mobilization efforts, this by itself cannot realistically be expected to yield amounts approaching the level of resources required to sustain, let alone, accelerate the required rates of growth in these countries. In particular, long term investment flows are essential in complementing the national development efforts of developing countries in such areas as the consolidation of infrastructure development, technology transfer, deepening productive linkages and boosting competitiveness. A large majority of developing countries with low incomes and limited export earnings still need concessional flows to supplement their domestic capital accumulation and to sustain their development efforts.

The origin of the flow of finance to developing countries can be seen as part of the evolution of the international financial system. One issue that emerged very clearly immediately after the great depression of the 1930s and again after the Second World War is the role of coordination and cooperation among countries on financial and trade matters to ensure full employment, and to guarantee prosperity, and economic growth.

The past 50 years have witnessed the evolution of development thinking and practice, and emergence of a large number of institutions, organizations and agencies at all levels in what is now popularly referred to as the international financial system. Bestriding this

[1] A recent study by the World Bank agrees that aid positively affects economic growth, and reduces poverty, only when it flows to countries with stable macroeconomic environments, open trade regimes, protected property rights as well as efficient public institutions that can deliver education, health and other public services. The issue however is how to attain these lofty policies.

broad field of international development and the international financial system is the colossus of development finance. Located in this intersection are international and regional organizations such as the UN agencies, bilateral assistance agencies, private foundations, the Bretton Woods institutions and a myriad of multilateral development banks. And as should be expected, with the plunge in development finance, most of the flak on multilateral finance, particularly in the past decade, has fallen on these institutions.

Thus, there has emerged a clarion call on the restructuring of these institutions if development financing which has played such an important role in moving the world to the frontiers of growth is to be sustained. Although it has been recognized for some time that there is need for a reform of the international financial system to cater to the development assistance needs of developing countries, it was the 1997 Asian financial crisis that spawned the debate on the weakness of the international financial system and created a frantic search for remedies. To situate the debate within the ambit of the present work, a distinction ought to be made here. It is generally recognized that there are two different, though interrelated, demands on the services of global financial institutions. The first demand is systemic in character and is associated with macroeconomic and financial stability as a 'global public good' which generates positive externalities for all international market participants (whether developed or developing) and precludes negative externalities associated with contagion (Ocampo 2002). The debate centres mainly on problems caused by the volatility of short-term capital flows, and, in particular, on ways, not only of managing crisis once they break out, but also of anticipating and preventing them in the future.

The second demand stems from the recognition that the world economy is not a 'level playing field' but is, in all practical ways, inundated with asymmetries which have a mainly north-south coloration. The asymmetries are associated with differences in financial development between developing and industrialized countries, and with developing countries' greater macroeconomic vulnerability to external shocks and their limited means of coping with them (Ocampo 2002; ECLAC 2002). The overall effect of this is that whereas developed countries have greater room for manoeuvres to adopt counter-cyclical measures and elicit a stabilizing response from financial markets, the opposite is the situation for developing economies. The high concentration of private finance in a few developed and emerging market economies and the rationing of such to low-income and many middle income countries are a further manifestation of these asymmetries.

While it is widely recognized that both systemic stability and developmental issues are crucial in the current debate and beneficial for developed and developing countries alike, there can be no denying the fact that the debate has mostly failed to address the most pressing problems that the low-income countries face, namely the availability of development finance, especially long-term finance. To reiterate, the attempt here is not to denigrate the systemic stability debate. For instance, while the Asian financial crisis affected the entire world economy, its effects were much more mordant for the developing economies as a whole than for the developed ones. Nevertheless, the financial architecture debate has been too lop-sided tilting more as it were towards the resolution of systemic crises and less on securing the flow of development finance to the most needy regions of the world.

Viewed from this perspective, this paper focuses more on the reform of the development finance institutions to enable them discharge their development finance goal.[2] It reviews the lessons learnt from international experiences in development finance from the particular perspective of developing economies whose growth and stability depend to a large extent on the availability of long-term external finance. The paper is divided into five main sections. Section 2 examines some of the dynamics underpinning development aid and their implications for institutional reforms. Section 3 undertakes a review of some of the major problems encountered under the present arrangement of aid delivery. In section 4, various suggestions for reforming the financial system are examined while section 5 recommends actions necessary at the country, regional and international levels for reforming the system.

2 The dynamics of development aid

The basis for development assistance derives from its role in developing countries where there is a paucity of savings.[3] The end-use of development finance is as multifarious as the delivery channels and as complex as the targeted programmes and objectives. These could range from poverty reduction, women empowerment, containing ethnic conflicts, protecting the environment, assisting refugees, to assisting drought stricken communities and building local capacity in the recipient country, etc. Because of the multiplicity of delivery channels, it is to be expected that performance may sometimes fall below expectations.

The observed failure of development aid to promote economic growth particularly in the 1970s brought most aid programmes under severe criticism. The major criticism against development assistance falls into three categories: those that consider aid harmful, those that consider development assistance beneficial but inefficient, and those that consider it appropriate only for the poorest countries.

The first group is the radical critique of developmental aid. This group argues that development assistance is harmful and that it even encourages laziness on the part of recipients. To this group, ‘aid is inherently bad, bad to the bone, and utterly beyond reform’ (Hancock, 1989). The second group, instead, focuses on the inefficiencies that have be-devilled the method of delivery of aid by international development institutions. To this group, aid is not bad and could be made to work better if delivered through appropriate channels and if targeted at countries that have put in place appropriate domestic policies. The third group emphasizes the need to draw a line between those activities that are essentially private sector oriented and those of a ‘public-goods nature’. Multilateral development agencies, it is argued, should focus their operations on those activities, which the private sector might not be willing to undertake. The review of the performance of development finance institutions therefore focuses mainly on the last two criticisms. By now, in spite of the dissension of a few radical scholars, it has

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2 A number of suggestions have been made on how to reform the international financial architecture and address financial crises in several countries. Measures to strengthen the financial system, promote adherence to international standards of good practice etc are addressed in this paper only to the extent that they may facilitate the flow of development finance.

3 The 2-gap model provides justification for foreign capital and their role in economic growth (Chenery and Bruno 1962: Chenery and Strout 1966).

become an accepted fact that aid works, but it could work better in promoting growth and reducing poverty.

2.1 The internal dynamics of the aid process

Any attempt at better understanding some of the explanations that have been advanced for the general ineffectiveness of development assistance should start from an understanding of the internal dynamics driving the aid process. Some of the main elements behind this internal dynamics include the conflict between the views of donors and the objectives of recipients, commonly styled the politics of aid, and the ever changing consensus on what constitutes ‘development’ (Kanbur *et al.* 1999).

Recipient countries need aid because in the face of volatile private capital flows and underdeveloped domestic financial markets, aid becomes an indispensable source of financing domestic development. Donors, besides the urge to promote economic development, are also influenced by a variety of political interests such as the need to maintain ‘normal’ relationships.

After the Second World War, the primary goal of development assistance was to spur economic growth. The position has long changed. While growth is considered important and continues to receive some emphasis, the focus of development assistance has grown to encompass such issues as poverty alleviation and capabilities (the ability to partake in the life of one’s community). In recent times, development is defined to include issues like income inequality, protection of the environment, and the advancement of human rights. Two problems have arisen from this changing view of development. First, as the conception of development has changed, the strategy for achieving it has also changed. Second and more important, it has also led to development assistance institutions and donors dictating conditions that must exist in any recipient country to qualify for aid.

The interaction of the politics of aid and the lack of consensus on a development strategy has led to two main end results. At the policy front, donors have continued to use development assistance to influence recipients the way donors think right. One way to do this is to attach conditions of policy reform to aid disbursement. Consequently, recipients can hardly claim ownership of projects financed by donor agencies. At the realm of projects, donors have pursued their individual institutional mandates and interests through a breed of their own projects. The result, project proliferation and lack of coordination. The issues raised here, conditionality, ownership, coordination and concessionality are at the centre of the reform of the aid process, particularly the reform of institutions. We briefly examine the issues here.[4]

2.2 Consequences of the internal dynamics of the aid process

2.2.1 Conditionality

Most aid programmes are conditional upon the implementation of certain policy reforms. However, it is becoming increasingly accepted that the effectiveness of aid

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4 The author assumes that these have been fully discussed elsewhere within the UNU/WIDER research project. However a more detailed treatment can be found in Kanbur *et al.* (1999) and European Commission (2002).

requires a national commitment to the reform process. This implies that the conditionality associated with adjustment lending is unlikely to stimulate reforms unless it is in line with the recipient government's own programme. Where such conditions were considered inimical to the economies of some recipient countries, the reforms were abandoned. Conditionality might be deemed irrelevant because it does not correlate with policy reform or aid flows. Moreover, it comes at a cost to recipient countries. Recipient countries that are already resource constrained end up spending a greater part of their time satisfying the conditions stipulated by donors.

2.2.2 Ownership

The perceived failure of conditionality led to a new emphasis on ownership of the reform process by the recipient countries' government. The idea here is that the specific conditions in recipient countries should be the main determinant of development strategy, not the constantly shifting priorities of donors. When recipient countries know that a project will serve their interests, they will want to own such a project. This is germane to the success of any aid activity. The new orientation in development finance aims at fostering recipient government's ownership of such programme.

2.2.3 Coordination and complementarity

Proliferation of aid and the lack of coordination have been major obstacles to aid effectiveness. The myriad funding agencies in developing countries have their own priorities and the current aid system provides all of them with outlets to pursue those priorities. The end result in most cases is a duplication of functions and activities by funding institutions. It also imposes a cost as the coordination, and monitoring of projects occupy the time of staff in almost every recipient ministry in a country. The inefficiency that arises from lack of donor coordination is an old, but still unresolved, problem. Some attribute this lack of coordination to the recipients' lack of absorptive capacity, others to the different objectives that drive donor programmes and again others to the multiplicity of aid agencies, each pursuing their own priorities.

2.2.4 Concessionality

There is an on-going discussion on increasing the share of development funding in the form of grants rather than concessional loans, as a way to better target poverty reduction and to prevent accumulation of unsustainable debt burdens. This has to do with the development strategy issue and invariably the institutional framework for the delivery of aid.

3 Institutional problems inherent in the current aid delivery systems

The major players in the current aid delivery system include the IMF, multilateral development banks (MDBs), the UN agencies, the WTO, and the Bank for International Settlements (BIS). The role of the BIS is more at the regulatory sphere and hence it will not be addressed in this sturdy.

In assessing the institutions reviewed in this work, three criteria are used. The first is the suitability criterion. In other words, given the functions that are enumerated, could these functions not have been better performed by other institutions? Is there an overlap? Second, what are the criteria that guide resource transfers and how suitable are these criteria. Finally, how adequate are the types of lending?

3.1 The multilateral development banks

3.1.1 Overview

MDBs are international financial institutions whose major shareholders include both borrowing developing countries and donor developed countries. They are able to mobilize resources from private capital markets and from official sources to make loans to developing countries on better than market terms. In addition, they provide technical assistance and advice for economic and social development and also provide a range of complimentary services to developing countries. Their product lines include, long term loans at below market rates of interest, concessional loans at very low rates of interest and long repayment periods, guarantees to enhance private investment, equity financing and direct lending to private sector operators, and relatively small amount of grant financing mostly for technical assistance, training and capacity building in borrowing countries.

A substantial part of net resource flows to developing countries is accounted for by the major MDBs. This has varied between 5-20 per cent in the last 30 years (excluding sub-regional institutions). MDBs have a large capacity to mobilize domestic and international resources. This is to be expected, given their ability to generate value added through policy dialogue, imposition of conditionality and offer of technical assistance (Swedish Ministry of Foreign Affairs 2000).

Table 1
Financial indicators for selected multilateral development banks, 1998
(US million dollars)

	IBRD	IFC	CAF	IADB	AfDB	AsDB	EBRD	EIB
Authorized capital assets	188,220	2,374	3,000	100,881	22,375	48,456	19,641	100,000
Assets	230,808	33,456	5,420	64,355	12,864	41,653	19,595	201,104
of which loans outstanding	113,688	6,241	4,059	37,385	9,026	24,698	4,917	87,974
Liabilities	202,787	28,112	3,997	52,582	9,039	31,590	14,523	181,479
of which borrowings	115,739	12429	869	39,553	7,582	23,744	12,562	337
Equity	28,021	5,334	1,423	11,774	3,825	10,063	5,072	19,624
Total liabilities and equity	230,808	33,456	5,420	64,355	12,864	41,653	19,595	201,104
Income expenses [a]	9,642	1,506	375	3,194	759	1,833	376	9,364
Operating income	1,647	249	93	568	158	467	43	1,187
Retained earnings at the beginning of the fiscal yr	16,733	2,998	440	4,156	1,572	6,496	134	11,577
Net income for the fiscal yr	1,518	246	93	568	142	464	43	1,967
Retained earnings at the end of the fiscal yr	17,909	3,244	533	4,724	6,961	1,714	177	12,624

Note: [a] Includes administrative expenses.
Source: Swedish Ministry of Foreign Affairs (2000).

About 25 institutions constitute what is generally regarded as the multilateral development bank system. The major actors consist of the World Bank; InterAmerican Development Bank (IADB); Asian Development Bank (AsDB); African Development Bank (AfDB); European Bank for Reconstruction and Development (EBRD); European

Investment Bank (EIB), and Andrea Finance Corporation (CAF) -Latin America and the Caribbean.

The World Bank (WB) is the pioneer MDB; its activities date back to its establishment in 1944. The WB is a complex organization consisting of the International Bank for Reconstruction and Development IBRD, the International Development Agency, IDA, the International Finance Corporation, IFC, the International Center for the Settlement of Investment Disputes (ICSID) and the Multinational Investment Guarantee Agency, MIGA. The agency at birth was conceived to borrow funds and lend these to qualifying governments for agreed projects at low interest rates for periods ranging between 10-20 years. Such loans were often made to governments of borrowing countries or public sector institutions with government guarantee.

The IDA was established in 1960 as an aid agency with its activities confined to a group of 60 countries mainly in Africa and South Asia whose classification falls into the least developed countries (LDCs) category. IDA credits are long term (up to 40 years) and contain a large grant component. The IFC came into being in 1956. It lends to private sector institutions without any government guarantee. The ICSID, which was established in 1966, was to function as an agent for the settlement of disputes arising from investment decisions. In response to world demand for an investment guarantee agency, the World Bank created MIGA in 1988.

3.1.2 The roles of MDBs

MDBs perform three main functions, namely, (i) financial resource mobilization; (ii) capacity building, institutional development and knowledge brokering, and (iii) providing regional and global public goods.

The financial resource mobilization function is by far the most important, as it underlies the other two functions. The basis for the existence of MDBs remains the provision of loans to borrowing countries. At inception, MDB loans were concentrated on project, programme and sector investment loans. With growth in the private investment, a gradual shift away from such loans as in transport and energy, roads, irrigation, and other traditional lending is envisaged. A number of MDBs are beginning to emphasize social sector lending (education, health, family planning, disease control) and institutional development in such fields as the reform of the civil service, judiciary and the sale of erstwhile public enterprises. More controversial, however, are the MDB loans for such purposes as redressing negative flows or volatility in private flows as witnessed during the financial crises in Asia, Mexico and Russia in recent years. What has also emerged as a major aspect of MDB resource mobilization function is the mobilization of concessional finance for the poor countries through their soft loan windows.

One area of MDB resource mobilization activities that is acquiring prominence is their participation in debt reduction operations. In the 1980s initiatives such as the Brady Plan and the IDA debt and debt servicing reduction strategy were essentially the preserve of the World Bank and the IMF. In recent times, most MDBs debt reduction involvement is being manifested in their role in the Highly Indebted Poor Countries (HIPC) Initiative. MDB role in the area of capacity building, institutional development and knowledge brokering includes technical assistance, policy advice, training programmes, and institution building by fostering consensus through dialogue and knowledge brokering through the spread of best practices and dissemination of information. In recent times, emphasis is being placed on good governance as a prerequisite for development. MDBs, accordingly, are being asked to help member countries improve public accountability and participation, fight corruption, and strengthen democratic processes. Other issues include private sector capabilities, the strengthening of public sector management and building capabilities in local policy analysis and project design.

MDBs are also becoming increasingly involved in the provision of public goods. They provide information about the international economic situation and the economic and social conditions in developing countries, conduct research on development issues, publish data on major development indicators, coordinate development assistance where possible and provide grants for disaster relief, agricultural research and training. Another emerging public-goods role is their involvement in environmental issues. Other MDBs' public-goods functions include peacebuilding and reconstruction efforts, and intervention to forestall health epidemics (e.g. HIV/AIDS in Sub-Saharan Africa). The involvement of MDBs in the avoidance of public bads such as money laundering, corruption, human rights violation, drugs trafficking, and in recent times terrorism is being seriously debated.

There is a lot of pressure generated in the performance of these three functions. First there are tensions between the financing and development role of MDBs. As should be expected, there are also tensions between the financing role and the public goods and development role on the other hand. This raises a lot of questions on the division of labour between MDBs and other agencies like the United Nations and other funding agencies.

3.1.3 MDBs and other funding agencies

Given the diversity of its operations, one issue that has dogged MDBs since their inception is the desirable division of labour with other agencies to avoid overlap and to ensure coordination. First, the question is raised as to why MDBs should lend to sectors in which private financing is available on 'appropriate terms'.

The next issue has to do with division of labour between the MDBs, bilateral agencies, and UN agencies. When there is no effective donor coordination, the costs to recipient countries of aid in terms of meeting the demands of donors constitute a real threat to already scarce resources. In the area of setting norms, establishing standards, and providing policy advice, an appropriate division of labour would envisage a role for other international financial institutions. The expectation is that when it comes to dealing with trade and financial issues, the IMF, the WTO and other UN agencies like the UNCTAD should have an edge over the MDBs.

One final point here is the division of labour between the MDBs themselves. This is more in respect of the division of labour between the WB and other regional MDBs. Where operations are on a larger scale transversing countries and regions such as of a global public-goods nature, the WB is expected to be able to harness resources for such projects. However, there are situations where operations may require a great deal of knowledge of the local environment such as in judicial or public sector reforms. The other MDBs are more at home with the latter.

3.1.4 Justification of the role of the WB in development funding

Questions have been raised concerning the WB in two critical areas. First, is the role of the WB to be a multilateral lending institution?, and second, is its function to be a knowledge brokering institution. The increase in private vis-à-vis official flows to developing countries on appropriate terms over the years has raised concerns about the Bank's continual involvement in this area.[5] Private flows have increased substantially over the years because of the increasing importance of private capital markets and regional development banks in many developing countries. In 1995, private flows accounted for almost 80 percent of total flows.

While this may be the case for middle-income countries, it is doubtful if the same can be said for IDA countries, most of which have been bypassed by the surge in lending observable in the 1990s and have continued to rely on the Bank. It is necessary to stress here that the belief that the development financing needs of most developing countries, including IDA countries, can be met by the normal working of the market system may be misplaced. The observation that such flows are actually concentrated in a few emerging markets and other middle income countries will continue to justify the involvement of the WB in development lending at least in the immediate future.[6]

The argument in support of the knowledge function of the WB is based on its public-goods nature. Critics have argued that the WB should leave development research to universities and other private consultants who can do this well. Knowledge has a public-goods character and when it comes to knowledge about best-practice development, it is a public good and the provision should be done by a global institution like the WB. Against the background of our discussion on information imperfection, it will not be too farfetched to expect the Bank to provide technical skills as part of its aid package by virtue of its development knowledge and experience. As the provider of public goods, the lack of symmetry between a rapidly globalizing private sector and the lack of private sector ownership of the externalities generated by the process of globalization foists this responsibility on a global institution of the magnitude of the WB. The gap between intentions and practice is wide in this area. The WB and, by implication, the IMF as principal lenders have a tendency to use their research to justify whatever their current prescriptions are in their lending programmes.

3.1.5 The World Bank and conditionality

The most widely held criticism of the WB's aid delivery method is the issue of conditionality. There are two opposite views on this. The WB is able to influence government policies favourably because of its7 conditionality policy. The argument here is rather circuitous. The WB, as a global multilateral development bank, has the reputation of being able to borrow and repay its debt and also lend to other sovereign

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5 See Summers (1999).

6 In a recent assessment, the International Financial Institution Advisory Commission set up by the US Congress revealed that 70 per cent of the World Bank's non-aid resources flow to 11 countries that enjoy substantial access to private resource flows.

Table 2
World Bank performance: failure rate of bank responsibilities

	1990-93	1994-97	1998 99	1990-99
Project identification	12 %	18%	22%	16%
Project appraisal	33%	38%	38%	36%
Project supervision	24%	28%	24%	26%
Overall	38%	44%	43%	42%

Source: Meltzer (2000).

borrowers at slightly lower interest rates. But this ability to borrow derives from the researched knowledge it has and hence its ability to device conditions on loans and impose these conditions on its clients. Also, the WB has the ability to monitor loans and projects and so ensure that contractual lending terms are honoured. This it assures by imposing conditionalities, otherwise the returns from projects may not be enough to induce further investment (Gilbert *et al.* 1996; Rodrik 1995; Mosley *et al*. 1995 and Gilbert *et al*. 1999). Thus the conditionality imposed is supposed to influence the behaviour of governments and correct their failures.

The other view derives from the failure of the premise on which the Bank's conditionality argument rests—the belief that conditionality works in the direction suggested. The ineffectiveness of conditionality is well documented (Killick 1998; Mosley *et al.* 1995). Conditionality is besieged by a number of problems. There is the fact that it results in time inconsistency. Most borrowing nations ex ante defer to conditionalities as a means of obtaining much desired funding. Once the aid is disbursed, the incentives fall away and countries may simply renege on the conditions they agreed on ex post. Moreover, governments hardly own development policies when conditionalities were imposed especially where these conflict with domestic realities. The result is that such reforms are hardly successful as would have been the case, were governments to willingly buy intro development projects. The overarching evidence from many developing countries is that structural adjustment lending even when it raises export performance, often results in lower investment growth and hence reduces output. This finding casts aspersion on the WB emphasis on good policy environment defined within the Bretton Woods framework as the fulfilment of conditionalities.

The other related issue is the project evaluation process of the WB. The process has been rated low in terms of its credibility. It is befuddled by what has been described by critics as 'wrong criteria with poor timing'. WB projects are rated on three measures: outcome, institutional development impact and sustainability. The issue of sustainability is critical for developing countries but is weighted only 5 per cent in the overall evaluation. Often results are measured at the moment of final disbursement of funds whereas evaluation should be a repetitive process spread over many years, including well after the final disbursement of funds when an operational history is available. This again points to the lop-sided weight attached to countries' ability to comply with conditionalities, which is expected to be reflected in outcome and development impact.

3.2 The International Monetary Fund, IMF

3.2.1 Historical background

The IMF was also established in 1944 as a response to the confusion that pervaded in economic and financial arrangements immediately after the Second World War. Over the years, it has undergone a lot of transformation in line with changing economic circumstances. The move by many countries from a fixed exchange rate arrangement to floating arrangements, the removal of exchange controls on both trade and capital movements, the oil shocks of the 1970s, the debt crises and the Mexican response in the early 1980s, the Asian crisis in the late 1970s, the events in the transition economies at the end of the cold war and the response of the IMF to these events are some of the factors that have shaped the IMF's evolving structure. They have also constituted the basis for most of the criticisms that have been levelled against the institution.

3.2.2 IMF and the developing economies

The US commitment to keep the dollar price of gold at US$ 35 per ounce came to an end in 1971. By August of the same year, the fixed but adjustable exchange rate arrangement ended and by March 1973, major operators concluded that the fixed exchange rate arrangement had gone for good. This also ended IMF's central mission. In the search for anew role, the IMF took on dealing with the financial and economic problems confronting the developing countries. It provided advice to developing countries in the area of fiscal, monetary and foreign exchange policies, which it considered conducive to stable balance of payments conditions. In the process, it offered loans to countries that took its advice.

The IMF took on yet greater responsibilities in the 1980s and early 1990s with the collapse of the Soviet Union and the need to finance new financial restructuring in line with free market arrangements and sponsor mass privatizations. This new function saw a shift in IMF focus as a short-term lender to support balance of payments adjustment to a source of long-term conditional lending, offering in the process macroeconomic advice to developing and transition economies. This led to a remarkable increase in the number of long-term commitments of the IMF and a major shift in its existing role. This has, in turn, created a situation where poorer countries, particularly in Africa, have come to rely on the IMF as a source of long-term lending and have become increasingly dependent on the IMF. The consequence is that the IMF, since it has to grant such loans on the satisfaction of a specific set of conditions, now exercises an unprecedented influence on the national sovereignty of these countries. Worse still, some of these programmes have not ensured economic progress. The IMF's intervention in the Mexican crisis (1994-95), the East Asian crisis (1997-98), and the Russian crisis (1998-99) has evoked a number of criticisms.[7] While the IMF can point to some successes, the general view is that given the vast resources at its command, it has not been particularly effective at maintaining financial and economic stability.

[7] For an outline of these, see the Meltzer Report (1999: 17-21).

3.2.3 IMF and development assistance[8]

The criticisms against the IMF are multifaceted but attempts are made in this section to highlight those that are strictly related to development assistance in developing countries.

i) The lending role of the IMF and the use of conditionalities: A major criticism of the IMF is that it wields too much power over the economic policies of the developing countries. It is accused of using its vast resources and conditionality to control the economies of developing nations, often undermining the sovereignty and democratic process of member governments. The IMF is not accountable to the public in developing countries and this has also created the problem of ownership of its stabilisation programmes. The executive arms of government in many developing countries have been accused of using IMF requirements to extort concessions from the legislative arm. It is feared that this may shift the balance of power within countries and distort the fledging democratic institutions in place in some of these economies. The IMF, it is argued, depends too much on mandates and conditional lending imported from abroad and less on local decisionmaking or incentives to encourage this.

ii) It is also highly contestable if IMF interventions, whether long-term or short-term, have been effective in bringing about the desirable results in income or wealth increases.

iii) The mission of the IMF has expanded considerably that it now overlaps and sometimes conflicts with other financial institutions. Recently, while the debate on its role is still raging, the IMF expanded its mission to include the promotion of capital account liberalization (1998), poverty reduction (poverty reduction and growth facility 1999) and the offer of immediate access to financing during a liquidity crisis to members. Specifically, with the poverty reduction and growth facility, the IMF will be responsible for monitoring and setting conditions for almost all aspects of the borrowing countries' economic and social policies. This facility duplicates the functions of the WB and it is doubtful if the IMF has the necessary facilities in this area.

iv) Even as an institution designed to provide liquidity during crisis, the IMF cannot claim to have been very effective in the past. The mode of lending during crisis that involves protracted negotiations for the disbursement of staged releases over a long period of time may not be an effective strategy for responding to sudden liquidity crises.

v) The IMF has also been accused of creating disincentives for debt resolution when it lends to insolvent sovereign borrowers.

vi) Finally, the IMF's governance structure does not make for proper accountability and limits its ability to pursue solely economic objectives.

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8 See the Meltzer Report for fuller details.

3.3 The United Nations agencies

The United Nations system is composed of a wide range of activities from peacekeeping, human rights and disarmament (UN), through social development (UNICEF), health (WHO), labour (ILO), refugees (UNHCR), food or famine prevention (WFP), to technical assistance (UNDP) and trade (UNCTAD), and many others. Like the WB and IMF, it was a post-Second World War creation designed to ensure world peace and security and promote even development. The evolution of the UN in the last half-century has been strongly influenced by two main factors or divides. The east-west divide which was responsible for the cold war greatly limited the UN's ability to perform its political role, the maintenance of peace and security and the north-south divide which hindered the UN from the performance of its function of promoting development. The east-west divide gradually petered out with the end of the cold war and this has left the UN system more in the arena of building consensus on development. This is not to say that skirmishes of intra-regional conflicts do not still abound but the ogre of an east-west conflagration that hung over the world from the 1960s to the late 1980s seems to have simmered over.

The need to cooperate and co-exist within established international arrangements has been stressed in a number of literature (Kapur 2002; Nayyar 2002; Martens and Paul 1998) and it needs not to be rehashed here. Simply put, international institutions such as the UN are mechanisms for transnational cooperation and collective action. Institutionalization serves to anchor international cooperation. Such institutional arrangements help to lower transaction costs of members and produce information linkages across issues and they serve as agents that both create and diffuse ideas, norms and expectations. They need to be able to operate sometimes very complex organizational structures and administrative apparatus to provide a forum where durable negotiations can take place and where members can interact. Secretariats are needed where consultative and supportive services are provided for members. It is at such institutions that decisions are taken to help shape understanding and mediate member disputes.

3.3.1 Financing the development activities of the UN agencies

At the centre of the north-south debate has been the issue of financing agreed plans of actions reached at major UN conferences. The unwillingness of the north to provide the type of development financing envisaged by the UN is not unconnected with the perceived improvement in the role of private investment, especially after the 1980s. However, it must be universally acknowledged that private investment, whose main motive is profit, cannot substitute for the financing of public goods and bads. Public investment will continue to be needed, especially in areas where private investment will not be attractive enough.

This trend is going to worsen as the pace of globalization proceeds. Globalization is a market driven process and like any other market driven activity, it may reinforce or accentuate exclusion. Those excluded either for lack of assets or capabilities may find it increasingly difficult to get rehabilitation because of the dwindling power of the state, a situation that has worsened with increasing integration and internationalization. In the past, national governments intervened through economic policies to take care of the interests of those excluded. In the evolving international context, this role of government is being emasculated (Nayyar 2002).

It is a fact that even as globalization and internationalization have moved unimpeded, the development of the global institutions of governance has not kept pace. There has, therefore, emerged an institutional gap. The present focus of the IMF and WB are very restrictive. The UN will always be needed in war-torn countries, in crisis ridden economies and in the development of democratic institutions, especially in developing countries. There will remain the need to protect the global commons, deal with currency crises as they occur, foster sustainable patterns of consumption and production and prevent inter-state or international conflicts. Challenges of this magnitude will require concerted intergovernmental efforts and massive financial resources.

Two issues are of relevance to us here. The first is that it is not very clear if the mandate given to the UN and its agencies is well defined. The second, even where such a mandate is clearly defined, the UN and its agencies may not have the financial wherewithal to execute this. What the first calls for, is a clear division of labour among international institutions, and, the second, a change of heart by countries in the north about their role in the UN. As governments have cut their ODA contributions in the advent of increased private flows, they have also reduced their support for multilateral funding agencies like the UN. In particular, the UNDP has been quite hamstrung by this development in recent years. A few governments like the US, France, Germany and Japan have cut their contributions to this agency. The voluntary contributions fell from US$ 1,178 million in 1992 to about US$ 750 million in 1998.Voluntary funds have also been cut in the case of other UN and other regional development agencies, including UNICEF and UNIDO, while budgets based on assessments have been cut back as well in other agencies such as the WHO and ILO. The UN core budget supporting the UN secretariat and intergovernmental negotiation has also suffered severe cuts in recent years with attendant negative consequences for multilateral development and planning.

4 A review of proffered solutions to the institutional problems

A number of solutions have been proffered towards resolving some of the institutional issues raised in section 3 with the view to improving the volume and effectiveness of development assistance to needy countries. Some of these proposals are radical, others bordering on the eccentric. For example, Kanbur and Sander (1999) have suggested what they called the ‘common pool’ to which donors are to contribute and from which disbursements are to be made to recipients, without regard to donor’s self-interests. Others have concentrated on how to revamp and strengthen the multilateral development finance institutions such as the MDBs (You 2002; Eccles and Gwin 1999). Among the most recent and most controversial are those by Klein (1998) and Meltzer (2000). This section attempts to review some of these suggestions. The treatment is in two distinct but interrelated parts. First we consider suggestions that deal with the aid delivery process. The second set of reforms focuses on the suggestions that have been made with regard to enhancing the performance of these institutions so as to increase the volume of aid.

4.1 Measures aimed at improving on the effectiveness of aid delivery

The central preoccupation of these measures is to address the issue of ownership of the aid process. Earlier, we argued that the lack of ownership has constrained the effectiveness of aid delivery to many recipient countries. In order to address this, a number of suggestions have been made to involve recipient countries in the design and implementation of projects. Among these are the 'common pool' approach, the 'sector-wide approach', the 'comprehensive development framework' (CDF), and the HIPC Initiative.

4.1.1 The sector-wide approach to development aid

This approach can be viewed as a precursor to the comprehensive development framework and the common pool approach. The underlying factors in this approach are: (i) the realisation that individual projects standing on their own may have limited impact where there is no adequate sectoral policy and (ii) even where there is adequate sectoral policy, donors have come to accept the fact that policymakers in developing countries may have difficulties coordinating the different projects on-going at the same time and thus be unable to determine the impact of the totality of activities in a particular sector at any point in time(Kanbur *et al.* 1999).

Some of the elements of the sector-wide approach include:

- First, the recipient country comes up with its overall strategy for the sector and donors sign on to support the strategy;

- National governments are encouraged to co-fund such sectoral strategies once identified and considered in line with national development goals;

- The approach rests on a basket funding system where donors do not provide funds to specific projects but for a sector within which many projects could be undertaken by implementers; and

- As they design their own sectoral strategy and devolve much of the activities to lower levels of responsibility, policymakers create an atmosphere of inclusion and this will spin off into more positive achievement.

The sector-wide approach has been widely used in the health sector by the WB in Africa, particularly in Zambia (1993-97) and Ghana (1996). One major shortcoming of the sector-wide approach is the inability to ensure country ownership of donor funds. Funds are not necessarily allocated through the sectoral pool, although donors accept a uniform arrangement for accounting, budgeting, progress reporting, etc. The reason for this is simple. Donors are not very confident of the local capacity in financial control and reporting in recipient countries. The result is that while government ministries take control of their sectoral programmes, donors implement the strategy largely on their own. Nevertheless, the reported success rates in Zambia and Ghana testify to the fact that the SIP did provide a solution to a certain degree to the problem of ownership and coordination.

4.2.2 Partnership approach to development aid: the comprehensive development framework

The need to adopt a broader and more inclusive approach to aid delivery spurred the move to national development strategies. Like the sector approach, the partnership arrangement is designed by the country and then supported by donors. The idea of a partnership can be traced to Pearson (1969), though this has now become widely embraced by the UNDP, OECD and other development agencies. Currently, the most widely discussed is the World Bank's partnership effort (World Bank 1998). The paper gave birth to the CDF as a further step for tackling the problem of coordination in partnership arrangements.

Schematically, the partnership proposal outlines three stages in aid delivery:[9]

i) The recipient country evaluates its needs and on the basis of this prepares a national development strategy after interacting with the private sector, civil society and other stakeholders. The practice enables recipient countries to build a consensus on development focus through debate and dialogue. A national development strategy is then designed based on the needs articulated;

ii) A financing mechanism is then planned for the strategy. This is done by convening a meeting of the 'development partners coalition' consisting of donors and recipients in the recipient country's capital. Two objectives are served by this meeting. First, in line with the recipient country's strategy, donors design their individual action plans and make their pledges. Second, donors utilize the opportunity to coordinate their assistance strategies through the formation of 'partnership frameworks'. In forming such frameworks, individual donors exploit their comparative advantages in the recipient country's programme and also discover areas of possible collaboration with other donors; and

iii) Finally, based on an understanding of their relative efficiencies, donors institute a common arrangement for the implementation, monitoring and assessment of the projects.

Though the process provides a nucleus for the distilling of national consensus between donors and recipient county, donors, based on their identified comparative advantages, will still continue to select specific projects from the national strategy for funding. This still creates a problem for coordination and monitoring. In an attempt to resolve this, the World Bank in 1999 proposed the CDF.

The CDF encompasses most of the ideas in the partnership document. In principle, it recognizes the need for recipient countries to own their development strategies. Some of the key elements of the CDF include (i) country ownership of the policy agenda; (ii) partnership with all stakeholders; (iii) taking a long-term comprehensive approach built on national consultations, and (iv) treating social and structural concerns equally as macroeconomic and financial concerns.[10]

One interesting aspect of the CDF, which is designed to help resolve the problem of coordination, is the use of the CDF matrix. The matrix is supposed to assist with the organization of a country-focussed programme by 'capturing the strategic priorities of the country, as well as who is doing what and where'.[11] The matrix represents, at any point in time, a visual impression of the development assistance in any given country.

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9 This is detailed in Kanbur and Sander (1999).

10 World Bank (1999).

11 World Bank (1999).

As useful as the tool is, it has generated its own problems. The question remains as to who draws up the matrix—the WB or recipient country? If it is the WB, will the country be in charge of the process? Which donors will help the most? The fear here is that the process might still be donor- or WB-driven.

One other aspect of the CDF that is of interest here is the issue of consultations and partnership-building with other actors in the development arena. For instance, the Bank has established key focal points for the purpose of consulting on CDF implementation and related issues. Such focal points include bilateral arrangements with the DAC, OECD, and such other country groupings like the Nordic group; the UN focal point and the multilateral focal points comprising of organizations currently engaged in different pilot activities in recipient countries. Each of these focal group provides the Bank with feedback on progress on the ground and the effectiveness of the working arrangements.

The CDF, like the sectoral strategy, falls short of providing a means through which the burden of individual donor projects can be alleviated. Donors still decide what specific projects they will fund, though, as part of the comprehensive country framework. The other problem is the issue of capacity. Capacity-building is an important ingredient for country ownership. This will remain a challenge for many recipient countries for many years to come. The next approach attempts to tackle the first of these problems.

4.2.3 The common pool approach to development assistance[12]

A major constraint on the effectiveness of aid identified earlier is the lack of ownership of development projects financing. To reiterate, donors have their own perspectives which determine the programmes they are willing to finance. Recipient countries have to contend with their unique histories, political economies and ideas on development strategies, which influence their behaviour. In the words of the proponents of this approach, there is an ‘agency problem’. Principals in this case donors use ‘sticks and carrots’ to induce agents to undertake a specific course of action. Examples of such methods are the imposition of conditionalities on policy reform and standardized reporting requirements. The end result is a collection of highly variegated aid delivery systems within a country with the attendant costs to recipients. This tends to undermine ownership of the programme in recipient countries.

The common pool approach is supposed to work as follows:

- Recipient country develops its own strategy, programmes and projects in consultation with its constituency and dialogue with donors;
- Presents plan to donors. Donors will be expected to put unrestricted financing into a common pool;
- Recipient governments would also contribute to this common pool;
- The level of financing by each donor would depend on its own assessment both of the strategy and the programme and also the recipient country’s ability to implement the strategy and effectively coordinate project and outlays;

[12] The discussion here focuses on the Kanbur *et al.* (1999) version of the common pool approach.

- Donors funds will not be allocated to specific items, neither will donors be allowed to monitor specific projects or items therein; and

- This common pool will be expected to finance the overall development strategy.

The common pool approach will ensure ownership, allow for mutual resolution of differences of opinions in the development process and tackle the problem of aid coordination. Because recipient countries will now have the responsibility for formulating and implementing development strategies, ownership will increase and implementation will be more effective. Kanbur *et al*. (1999) recognize the fact that in the short run, the volume of aid might fall. They, however, contend that such a drop-off can be planned for and the available volume of aid can be more effectively utilized. In the medium to long run, the efficient utilization of the aid available in the short run will present a basis for arguing for more aid. On the part of donors, the approach will reduce the need for staff to develop, monitor and evaluate individual projects, or to monitor compliance with conditions.

4.2.4 Debt relief as development aid: HIPC Initiative

The HIPC Initiative was launched in 1996, to serve as a framework for negotiations and for the provision of debt relief to debt-burdened developing countries. As conceived originally, eligible countries went through two stages of three years each to qualify for debt relief. In the first stage, the country is required to establish a track record of good performance in the implementation of an economic reform programme under the enhanced structural adjustment facility of the IMF. In return, its Paris Club creditors would commit themselves to rescheduling debt service payments so as to achieve roughly a 67 per cent reduction in the net present value (NPV) of eligible debt, while non-Paris Club members would provide comparable relief. On completion of the first stage, the country is supposed to pass a decision test. At this point, it is decided if the country would qualify for an HIPC debt relief if the Naples terms' reduction it had obtained did not exert any noticeable impact in reducing its debt stock to a sustainable level. During the second stage, the Paris Club creditors would provide additional debt service relief up to 80 per cent in NPV terms (Lyon terms). The non-Paris Club members will also provide relief. At the end of the second three-year stage, a 'completion point' is reached when the creditors would reduce the country's debt burden to a sustainable level, implying up to 80 per cent stock relief in NPV terms.

There were misgivings about the extent of debt relief and its sustainability under the original HIPC Initiative. Also a number of questions were raised as to the wisdom of waiting until the completion point before debt relief is granted. The Cologne Initiative (1999) sought to effect changes in the original scheme in at least four ways: (i) by accelerating the pace of debt relief through the provision of interim relief before the 'completion point'; (ii) by allowing countries to advance the 'completion point' by accelerating the pace of policy reforms; (iii) by broadening country eligibility through changes in the sustainability thresholds, and (iv) the Cologne Initiative also sought to link debt relief to poverty alleviation (Botchwey 1998).

4.2.4.1 Problems with the Initiative

The HIPC Initiative suffers from a number of shortcomings. From the perspective of the creditors, there are anxieties about finding resources to meet the additional financing required to meet the enhanced initiative which is estimated to have grown from

US$ 12.5 billion to US$ 29.3 billion. The bilateral and commercial creditors will bear nearly half of this cost, leaving the multilateral development banks (including the WB) with about 41.8 per cent and the IMF about 8.1 per cent.

Generally, there are pitfalls in the arrangement. First, it is feared that the criterion for determining the ability of the HIPCs to pay their debts is inappropriate. Fiscal position, rather than the ratio of debts-to-exports, is a better reflection of a country's ability to pay its debt. The arrangement assumes that all exports proceeds accrue to the treasury and debt service payments are made there from. Second, the programme misses the fact that these countries need large transfers from the rest of the world and that, for the most part, they pay their debts at the expense of investments in physical infrastructure and human capital; and third, the current mechanisms for easing the debt burdens of these countries leave them with marginally positive net resource flows that are grossly inadequate to meet urgent social expenditures.

4.2.4.2 Resolving the international debt crisis: the insolvency and bankruptcy processing of sovereign debt

In view of the numerous problems encountered with the HIPC Initiative, various suggestions have been made towards resolving the international debt crises. One of such initiatives the insolvency and bankruptcy proceeding of sovereign debtor championed by the Jubilee 2000 organization.[13] The Jubilee Framework for international insolvency consists essentially of three elements.[14] First, a sovereign debtor should be able to determine at what point repayment of foreign debts is being made at a cost to human rights or dignity of the people of that country. Where debt reduction proves unattainable, the country should be able to file for a 'standstill' on debt repayments through an unconditional right to petition. The second step involves the country seeking protection from creditors in an insolvency court. A number of controversies still surround the mode and composition of the insolvency court but one thing that is emerging from the debate is the need to sequester the IMF from this role. It is strongly felt that an independent panel/arbitration court made up of equal numbers of nominees from both the debtor country and representatives of international creditors be put in place to perform this role.

Finally, the court will be charged with certain responsibilities, prominent among which are (i) determining whether sovereign debts were legally and properly contracted; (ii) ensuring a public debate of outstanding portfolio of debts through the involvement of civil society and (iii) checking whether, as has often happened in many countries in the past, private debts contracted without the knowledge of central governments have been retroactively 'nationalized'. Other functions of the court will include ensuring that (i) creditors are treated symmetrically (creditors like the WB and IMF are not given preferential treatment); (ii) preventing capital flight from debtor countries, and (iii) protecting the human rights of citizens of the sovereign debtor. The underlining principle in the framework is the involvement of the people in a debtor country in crisis that impacts directly on the quality of their lives.

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13 Two principal proposals have generally been discussed in the literature. Anne Krueger (2001) and the Jubilee Coalition (2002). Krueger (2001) proposed a sovereign debt restructuring mechanism. The Jubilee coalition proposal is discussed in this work.

14 See Pettifor (2002).

4.3 Institutional reforms measures

The reform of institutions delivering aid is considered crucial from the point of view of increasing the effectiveness and volume of aid. The institutions considered in this section include, the UN system, the WTO, the Bretton Woods institutions and the multilateral development banks.

4.3.1 The United Nations

4.3.1.1 Burden sharing

The sustenance of the UN agencies—most of which are partly financed by members' assessed contributions and voluntary contributions—is relevant to the development financing issue. The major handicap the UN faces in financing its development goals is the fact that member nations are in arrears in their contributions to the annual support of the UN.[15] Thus, the system now faces a dwindling resource base. Although the Charter of the UN states that, 'the expenses of the organization shall be borne by the Members as apportioned by the General Assembly', the Charter does not provide for any distinctive guidelines on the principles of apportionment. A number of suggestions have been made on how to apportion the total budget of the UN to its members. One of the most recent is the Burden sharing approach popularized by Klein.[16] The approach rests on some basic principles for apportioning the budget of the Secretariat of the UN among members.[17] Some of these principles include:

i) Assessment should be based on the ability to pay: this simply implies that the larger and more prosperous countries should bear a larger part of the burden. The richer the country, the more it should pay;

ii) Progressivity of the assessment: progressivity means that as one moves up the income scale the ratio of incremental assessments to incremental income should rise across countries. In other words, the marginal assessment should be an increasing function of the per capita income levels;

iii) Horizontal equity: fairness demands that people or countries at the same per capita income level should have the same per capita assessment, and

iv) Transparency: this means that the rule of assessment should be simple, understandable to all, and formulated in terms of available data and objective.

The beauty of the approach recommended is that by playing around the equations devised to tackle each of these criteria, exemptions can be made for special cases on the basis of debt burden, ecological disasters such as drought, income inequality, or some other aspects of poverty. A hypothetical calculation by the authors based on figures for

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[15] The political aspects of the reform of the UN are not attempted in this work. For issues relating to the governance of the UN, see Falk (2002). We appreciate that these political considerations cannot be separated from the purely financial, but space does not allow us to delve into the political reforms in this study.

[16] See Klein and Marwah (1997). This study refers specifically to the funding of the UN secretariat.

[17] The emphasis of the approach is on the Secretariat because most UN agencies have different methods/sources of raising finances for their operations.

1993 shows that the 31 industrial countries at a high level of human development index (HDI) would bear more than 90 per cent of total UN financial burden.

4.3.1.2 Independent financing

The advocates of independent financing would base their argument precisely on the undesirable outcome of the Burden sharing arrangement. At the heart of the reform of the UN system is the need to free the finances of the organization from domination by a few rich countries. The argument here is that UN funding should be separated to some extent from government contributions. Various recommendations have been made on alternative modes of financing. Many of these involve the levy of international taxes such as the Tobin tax, the carbon tax, tax on aviation fuel, and tax on arms trade.[18] International taxes serve a dual role. They could be used to finance development.[19] In addition, they could be a veritable source for the provision of global public goods.

Debates on these taxes still span such issues as coverage, the base for the tax, tax rate, equity and efficiency. As appealing as these taxes look, there is strong opposition to them by the affected business interests. For instance, the major international banks are strongly opposed to the Tobin tax and oil companies are opposed to the carbon tax. There is also resistance on the part of governments who are afraid of losing tax as a symbol of national authority to a supranational taxing power. The US Congress has passed a law forbidding the UN from even considering global tax measures. The resistance to these forms of financing goes beyond the issue of money or national tax autonomy. The real issue here is political (Falk 2002). The introduction of these taxes will mean that the powerful nations will be gradually loosing their grip over the less developed countries, a development they will not countenance.

4.3.2 Reforming the Bretton Woods institutions

The need to reform the principal Bretton Woods institutions (IMF and World Bank) has been the subject of many recent debates. The ideas covered here relate mainly to reforms aimed at enhancing the flow of development aid to developing countries. These reforms have revolved around three major pillars: (i) reforming the governance of these institutions; (ii) the issue of conditionality, and (iii) defining the role of these institutions vis-à-vis other multilateral institutions.

4.3.2.1 Reforming the governance of the Bretton Woods institutions

A number of proposals have been made for the reform of the governance structure of the Bretton Woods institutions.[20] Here we attempt to summarize some of the main ideas:

i) The two institutions should devise ways of becoming more inclusive. In particular, the interests of developing countries must be taken into consideration in constituting the decisionmaking apparatus of the institutions. Specifically, it has been suggested that the Interim Committee and the Development Committee of the IMF which are currently just ceremonial

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18 For details of these alternative financial instruments, see, for instance, Global Policy Forum (1999) and Martens and Paul (1998).

19 See Brandt (1980) and also World Commission on Environment and Development (1987).

20 See for instance, Stiglitz (2002) and You (2002).

advisory agents be transformed into decisionmaking bodies with better representation of the developing and transition economies;

ii) Accountability and transparency should be strengthened. The idea here is to ensure that the governance and accounting structure of the institutions provide accurate information about their activities. In particular, decision by consensus should be replaced with open discussions and voting procedures (You 2002; Woods 1998). The officials of the institutions should be accountable for their actions, and reports should be made available and written in an understandable manner. When programmes fail, staff in charge should be held responsible. External evaluation should be strengthened and representatives from different countries should be included in all appraisal teams; and

iii) Democratic processes and sovereign authority must be respected especially in borrowing countries.

4.3.2.2 Conditionality

The practice of imposing conditionality was discussed earlier. To reiterate, imposing the same conditions on all countries irrespective of the structural problems underlying the balance of payments crises is, to say the least, improper. Second, conditionalities have expanded into areas that have no direct bearing on loan repayment thus infringing on national sovereignty (Collier and Gunning 1999). Third, conditionality may preclude the ownership of development programmes and projects. Finally, conditionality has been found to be generally not as effective for changing the policies of recipient countries or for improving economic performance.

A number of suggestions have been made by scholars with regard to the issue of conditionality (You 2002). These include (i) making conditionalities simpler and penalties stiffer for countries that quit (Mosley *et al.* 1995; Hills, Peterson and Goldstein 1999), (ii) having countries formulate their economic reform programmes, and (iii) making conditionality ex-post. The overriding objective should be to improve ownership of programmes. Simpler terms may reduce but not eliminate the ownership issue. Having countries formulate their own programme is already at practice with the WB but governments must be committed to reforms and the input of the Bretton Woods institutions should be minimal. By far the issue of ex-post conditionality seems best. institutions should be provided with financing once it is ascertained that good policies are in place without requiring conditionalities.

The use of institutional reform loans as an incentive to get countries to continue long-term reform programmes is strongly advocated by the Meltzer Report. The proposal involves the appointment of a third independent party to verify or certify whether conditionality has been complied with or not. Up till now, this has been the sole prerogative of unilateral determination by the lender. This will serve a dual purpose. It will help reduce the time inconsistency problem associated with conditionality whereby countries renege on the conditions agreed on after obtaining loans. Second, it will promote steady implementation since such loans will serve as incentive to sustain reform till the end.[21]

[21] See Meltzer Report (2000: 46).

4.3.2.3 Defining the roles of the institutions[22]

The objective under this reform is to strictly define the activities that each institution should be involved in. For the IMF, the following roles have been suggested:

i) IMF should serve only as a quasi lender of last resort to emerging economies Its activities should be tailored towards the provision of short-term (maximum of 120 days) liquidity assistance to countries;

ii) Thus IMF 'should cease to make other types of loans especially long-term loans requiring unending conditionalities to countries. In this regard, any long term institutional assistance to foster development and encourage sound economic policies should be the responsibility of the WB or regional development Banks' (Meltzer 2000). In this way, the IMF Growth and Poverty Facility is an over-extension;

iii) IMF should continue to act as a knowledge institution by collecting and publishing financial and economic data from member countries and disseminating such data in a timely and uniform manner.

iv) It should also continue to provide policy advice. The medium through which it currently does this, the Article IV Consultations, should be improved for transparency and dialogue; and

v) In connection with (ii) and (iii) it is also suggested that the IMF decentralize its research activities which are currently concentrated at the headquarters of the Fund. This will help to enlist ownership and involvement of the people.

4.3.3 Multilateral development banks

Although MDBs have a number of functions, their financial mobilization role for the poor and needy countries will continue to attract the largest resources. The focus of the development banks should be to target those poorest countries without access to private–sector resources with the objective of reducing poverty. The MDBs should continue to mobilize concessional loans for the poor countries through their soft loans windows.

The World Bank should revert fully to its development role. The WB needs to increase the focus of its efforts on the IDA countries and the provision of public goods that currently does not seem to attract private investors. Promoting investment in health and education, infrastructure development, and poverty eradication must continue to attract the attention of the WB. To do this, following reforms have been suggested:

- The WB should move away from loans to a greater emphasis on grants. Loans for social investment in 'good policy' countries may be of some use but in poor countries, it only leads to further immersion into poverty. In this regard, performance based grants should replace loans. Independent agents to ensure that

22 See Meltzer Report (2000: 26-9).

aid is targeted at effective poverty reduction programmes should audit performance;[23]

- The WB must continue to be a knowledge institution. This has been extensively discussed earlier. The WB must continue to assist with the development of the skills necessary for the implementation of projects, and offer policy advice;

- A more defined role between the WB and the IMF is long overdue. The IMF should focus on short-term and systemic problems (financial stability) and the Bank on the long-term development needs of poor countries. The argument here is that issues of international finance are closely linked to the interests of rich and powerful countries while development needs are strictly not. The Bank, therefore, should not devote its lean resources to such preoccupation (You 2002). For instance, the Bank's approval of the emergency structural adjustment lending procedure whereby it allocates funds to supplement IMF financing during crises is highly suspicious. There will always be cooperation between the two institutions. For instance, the WB will continue to stress the role of social policy as an integral part of the new financial system. Also, the Bank will need to continue to harp on the social dimensions of adjustment by providing technical assistance in required areas such as financial restructuring.

- There is need for clear demarcation of roles between the WB and other multilateral (regional) development banks. Regional development banks compete for donor funds, clients and projects with the WB. The organizational structure of the WB with emphasis on subsidized loans and guarantees to governments, zero-interest credit to the poorest members, and loans, guarantees and equity capital for private sector operations is duplicated by the development banks. The WB chooses to expand offices even at country levels when what is needed is closer coordination with regional development bank offices, given the impression of competition rather than cooperation. These may need to be sorted out to enable the WB perform its role.

- There is need for coordination of the roles between the WB and UN agencies, particularly in the areas of the supply of public goods and elimination of public bads.

5 Recommendations and conclusion

The suggestion of solutions or reform measures is a difficult task that requires the concerted efforts of seasoned international policymakers. Therefore, what is attempted here is, at best, a 'first shot' towards this end. Most of our discussions so far have focused on who is doing what as far as development financing is concerned. In this section we are more concerned with distilling these alternatives into an 'integrated and harmonious' reform policy package. Central to the reform measures proposed here is the understanding that any global finance package should have as its core the ability to lift the living standards of people, particularly in developing countries.

[23] See Meltzer Report (2000: 44).

Five broad considerations form the core of an institutional reform package. These are:

i) The global governance issue;

ii) Restructuring the financial system to achieve a network for effective operations;

iii) The role of the domestic financial system in the emerging structure;

iv) ODA versus private capital flows and their implications for institutional reform; and

v) Dealing with global goods and bads.

5.1 The global governance issue

The issue of governance permeates different operational areas of these institutions. There are two related concerns here. The first has to do with equity. The major shareholders in these institutions, i.e. the advanced, industrial nations (also the lending nations) are over-represented in the decisionmaking apparatus of the supranational bodies, leaving the borrowing countries without voice. Inadequate representation constitutes a problem in many respects. It limits the legitimacy of international financial arrangements. Second, it limits ownership of programmes. Third, to the extent that growth in developing countries can have systemic impacts, inadequate participation and hence commitment could engender greater vulnerability and retard world economic growth. Thus, this continues to be at the heart of the cry for the reform of these institutions.

The second issue is the compelling need for an international global financial institution that is able to impose common standards and codes that will be binding. The need for such a body derives first from the nature of capital flows. The Asian, Mexican and Russian financial crises have demonstrated the risks that financial crisis in any part of the world can create for the global financial system. And as shown by past experience, developing countries financial system are even more prone to risk when such crisis occur, as was evidenced by the fall in development assistance at the peak of the Asian crisis. The absence of developing countries in the Basle Committee on banking supervision, and their insufficient participation in the BIS are clear examples of the exclusion of these countries from the forums where crucial issues that affect them are discussed. This does not portend well, especially since the developing countries are expected to accede to decisions reached at these forums.

Thus, a critical issue is the need to increase developing country participation in the institutions where they already are represented but inadequately so. For instance, at the IMF, the International Monetary and Financial Committee (IMFC) and the development committee as well as the boards of the IMF and WB have a voting power which gives many developing countries inadequate representation (Ocampo 2002). The need to reform the out-dated quota system of the IMF has also been mooted in many discussions. Reform measures such as the restoration of basic votes, and the use of purchasing power parity (PPP)-based GDP estimates to correct the under-representation of developing countries are under discussion.

In addition to the reform of existing institutions, the proposal for the creation of a global council at the highest political level to provide leadership on issues on global governance has been on the table since 1995.[24] This council will have a broader base than the G7 or G10 or G20 or the Bretton Woods institutions, and although without legal authority, the council will be expected to provide political leadership and give direction on policy framework to promote development, ensure consistency in the policy goals of the major international organizations and promote consensus building among governments on issues of global economic and social governance (Zedillo 2000).

5.2 Restructuring the financial system to achieve a network for effective operations

The need for strong regional institutions and their effective linkage to existing international financial institutions to form an effective network for financial services cannot be over-emphasized. The role of regional financial institutions spans several areas. With the commitment to regional integration, there has been a blossoming of regional trade and regional capital market integration. Also, globalization has enhanced the growth of regional macroeconomic interaction. It also follows that certain functions such as surveillance of and consultations on macroeconomic policies, and peer review of national systems of prudential regulations and supervision are better performed at a regional level. Other support for the primacy of regional institutions include the risk-pooling argument, competition especially in the supply of services to smaller and medium-sized economies, and the sense of ownership that creates a special relationship between financial institutions and member countries. The federalist argument also lends support to enhancing the role of regional institutions. No matter what effort is put into reforming the existing supranational institutions, it is doubtful if the voice of the small- and medium-sized countries will ever be felt in these institutions. Thus, the small country, within a global order, stands a chance of being heard only when it is part of a regional block.

These arguments have been demonstrated in the effectiveness of such regional arrangements like the European Payments Union, the Arab Monetary Fund, the Asean Surveillance process and in recent times the Andrean Development Corporation. An arrangement whereby the IMF is at the apex of a network of regional and sub-regional financial transactions fanning out in a network is likely to be more effective in guaranteeing competition than the current centralized arrangement. Under the current dispensation, institutions are highly specialized. Such an arrangement may be better suited to providing services that cannot be sufficiently provided by any one institution. Second, it may be more balanced than a system based on a few world organizations (Ocampo 2002). This suggestion is very controversial because, as has been argued thus far, it may lead to some duplication of roles.

5.3 Domestic financial markets and the mobilization of resources for development finance

The reform of domestic financial markets and, in particular capital markets, is crucial for any successful domestic resource mobilization. The reform of domestic capital

[24] Commission on Global Governance (1995).

markets is central to the issue of attracting private capital flows. One of the greatest problems—and a common source of high borrowing costs—in many developing economies is the absence a of a virile capital market. However, private capital flows, as desirable as they are, can create their own problems because of their volatile nature. A basic lesson from the Asian crisis is that satisfying prudential requirements may not provide enough protection against sudden capital flows. Thus, the starting point for developing countries in solving their developmental finance requirement is to put in place measures, including financial systems that are adequate for successful domestic resource mobilization.

5.4 Official development assistance (ODA) versus private capital flows to developing countries

The declining trend in ODA flows to developing countries is a matter of concern. ODA was a major source of development finance to many developing countries until the 1980s, accounting for about half of total resource flows. However, beginning from 1991, this trend has been reversed, with this source of financing now accounting for only about 20 per cent of total. It is necessary to stress here that despite the general decline in official flows to developing countries, ODA *grants* have stayed relatively constant at around US$ 40 billion. Official loans, on the other hand, have fallen from US$ 27 billion to about US$ 9 billion during the last decade. Also, the proportion of ODA allocated to emergency and relief work as well as the administration of aid programmes has increased over the years even as aggregate ODA has fallen.

These findings have implications for institutional reform. First, MDBs must reposition themselves to be able to continue to mobilize concessional loans for the poor developing countries. A possible scenario for the future is that the total volume of ODA through bilateral and multilateral channels might remain at current levels in nominal terms. To be able to reach the poverty reduction targets set for the immediate future, donors may have to utilize the soft loan window of the MDBs. This can only happen if bilateral donor countries see MDBs as adding value and demonstrating a relatively strong comparative advantage in development effectiveness (Swedish Ministry of Foreign Affairs 2000). Once these conditions are satisfied, donor agencies will prefer to channel funding through MDBs rather than channelling such funds through their own bilateral agencies and incurring additional costs. The need for recipient countries to take ownership of such programmes/projects cannot be over-emphasized. This is why MDBs must fine tune the methods through which they provide concessional finance to borrowers. The current approaches being experimented upon, i.e. the common pool and the CDF may need to be perfected.

The other related issue is with regard to the growing allocation of ODA to emergency and relief work and administration. Granted that ODA flows are declining, if MDBs as part of their public-goods function decide to continue to finance this item, who pays for this? Two sources are immediately discernible. Either MDB borrowers could be made to pay higher loan charges or shareholders could contribute through higher levels of paid-in capital. Neither of these options is equitable for public goods. Moreover it is doubtful if MDBs would want to continue to subsidize the provision of such goods through transfers from their net income. This also introduced a larger issue. Should MDBs be involved in the provision of public goods? This raises the question of the division of labour between UN agencies which are better suited for this purpose and

MDBs whose activities should be restricted mainly to the financing role and peripherally to the knowledge-broker role but not the provision of public goods!

The flow of private capital to developing countries since the beginning of the last decade has elicited a lot of euphoria. The ecstasy derives from the assumption that this could compensate for the dwindling inflows of ODA. The sub-component of private capital flows that has witnessed the greatest upsurge is FDI. This development has fuelled the belief that the development financing needs of developing countries could be met by a reliance on the markets. There are a number of concerns with this development.

- Private investment will always target profit-oriented projects. It will not finance projects in the environment or other social concerns, though it has the potential to finance sustainable development. To depend on investors in the north to finance sustainable development projects in the south is expecting too much. This has nothing to do with sentiment. Not many private investors in the south will be expected to finance non-profit oriented projects.

- Private investment so far has been concentrated in a few mineral and oil producing nations. In Africa, a substantial part of private capital flows to the continent is absorbed by South Africa, Nigeria and Egypt. Other emerging market economies that have benefited from this upsurge are Argentina, Brazil, Chile, China, Malaysia, Mexico, Thailand and Venezuela. Most poor nations in Africa have not benefited from the new source of financing that is supposed to supplant ODA. Factors that are listed as the main determinants of FDI inflows such as the policy environment, high growth rates, low transaction costs, and market size, are not very common in these low-income countries.

- Private investment is highly speculative and very volatile. The extent to which they can be relied upon for long-term investment, particularly in an environment that does not have a long history of political and economic stability, is highly doubtful.[25]

- The record of private investment, particularly in developing countries where there are no environmental or social legislation whether it is Shell in Nigeria, Mitsubishi in Indonesia, or Nike in Vietnam, leaves much to be desired.

What does this mean in terms of development finance? First, it goes to show that private capital flows cannot be relied upon for the purpose of sustainable development in the least developed countries. The role of capital investment in the social sector—institutional, development, capacity building and knowledge-brokering, areas which the private sector will hardly go into—continues to justify the need for MDBs and concessional lending. Second, given the current state of capital markets development in many of the poor countries, ODA flows will continue to be a more dependable source of development financing in the foreseeable future.

Third, given the nature of the volatile and speculative movements alluded to earlier, it is necessary to put clear rules in place for international capital flows to protect the

25 Often regarded as a very stable 'nuts and bolts investment', findings have shown that FDI flows can be easily reversed through financial transactions (Lougani and Razin 2001).

economies of the many of these developing countries from these adverse capital flows. Many efforts are geared towards liberalizing capital flows and less on how to deal with any adverse consequences. Developed industrial nations are better able to deal with sudden capital movements. The IMF, as the institution charged with the balance-of-payments problems in developing countries, should enact policies to deal with this. Its bail out-operations in Mexico and Asia have attracted a lot of criticism. As long as the world's nations fail to adopt internationally agreed environmental and social standards, private foreign investment will remain a major cause of environmental degradation. The role of the UN in this area needs to be beefed up.

Finally, the role of private capital flows is often discussed in many policy papers without paying enough attention to the myriad of SMEs in many developing countries, FDI inflows focus more on transnational corporations. Yet the future path for growth and employment in many developing countries hang on SMEs. Efforts at reaching this segment of the market through MDBs have been very poor so far. The EIB loans targeting many of these companies have been a very poor case of the mode of delivery of development finance. In recent times, the IFC has also increased its efforts at reaching out to SMEs. During the period 1999-2001, SME-related lending by the IFC increased from US$ 1.5 billion to about US$ 2 billion, representing about 13 and 20 per cent, respectively, of their sectorwide investment for the period. Most of this is disbursed through financial intermediaries, especially commercial banks. But this in itself is a contradiction of some sorts and shows a lack of coordination in multilateral development bank lending. First, commercial banks by their very nature are not suited to long-term lending in many developing countries. Second, commercial banks have a problem handling out their own loans in many developing countries. So more often than not, they find MDB loans competing with their own lending operations. One then wonders why a more efficient network of lending cannot be established with the apex MDB, the World Bank, at the top going through regional MDBs and finally national development banks or similar investment institutions. The practice has been to cast aspersion on national development banks rather than reform them. Such criticism of national development banks is quick to point to the failure of such institutions in many developing countries in the past, justifiably of course. But the success of national development banks in Asia and South Africa which has been quite effective in the old Southern Africa should provide a challenge for policymakers in the study of these institutions. It is to expect too much when commercial banks are relied upon at the national level to perform the functions of a development bank. Development banks, whether at national, regional or global level, are unique in their function and distinct from commercial banks.

5.5 Public goods and bads

The issue of public goods and bads is gaining increasing prominence in public discourse. Globalization has not helped matters. The process of globalization is diminishing the power of sovereign governments, yet, there is no corresponding increase at the international level in the power of a supranational organization to regulate this market-driven process. In the absence of a super body to impose restraint, the fear is genuine that the world is likely to end up with a retinue of public bads such as environmental degradation, epidemics, arms trade and drug trafficking. Specialized UN agencies already exist to handle these issues. For example, the WTO, IMF, UNCTAD and the regional Economic Commissions of the UN are better positioned to handle some of the issues pertaining to trade and finance related development issues than the MDBs. The WHO (health), UNAIDS (aids pandemic), UNFPA (population) and a host of others are specialized in their different areas of services delivery. In terms of division of labour, the MDBs do not have any business getting involved in these areas if the UN system is well-funded.

The UN was founded on certain basic principles and common understanding among all nations—to foster world peace and bridge both the north-south and the east-west divide. More than ever before, international life is becoming more complex and it is becoming increasingly impossible to get nations to act where their personal interests are not at risk. The need to build consensus rather than impose rules is more in demand than ever before. These principles make the UN a more relevant institution when it comes to issues like human rights, environment, health, labour and global economic policy.

What is called for is a strengthening of the UN system both politically (governance) and financially to enable it to perform its development role. Politically, the decisionmaking apparatus of the UN needs to be restructured to guarantee adequate representation. In terms of funding, a supranational body that would command respect must be financially viable and independent. This has been the basis of our suggestion on the need to pursue a mechanism for securing some independent sources of funding for the UN system. The debate on the use of international taxes, that has been put on hold for some time, needs to be revisited.

We have attempted in this work to examine the main institutional issues involved in the delivery of development finance to developing countries. The debate on the reform of the international financial architecture has not come out very strongly in this area, at least not as forceful as it has been on the issue of the stability of the financial system. Aid will remain a major source of financing development in many developing countries where low domestic resource mobilization, weak institutional structures, low incomes and abysmal poverty have increased, even as we enter the new millennium. The increase in the spate of globalization, environmental degradation, and the surge in epidemics will only compound the existing inequality between the north and the south and create further threats to world peace if necessary policy actions are not initiated. Private capital flows will not be enough to address these developmental concerns.

To enhance the effectiveness of existing institutions, especially development finance institutions, there is need to re-define their roles to enhance their ability to mobilize and channel aid to areas where they are required the most. Second, we examined the existing division of labour among these institutions and concluded that a lot of overlap currently exists. To avoid confusion in the delivery of aid and ensure efficiency, we recommended basic guidelines that should determine ‘who does what’. This, in addition to improving efficiency, will remove the problem of aid coordination and economize on scarce resources.

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