The Future of Development Finance

Nemat Shafik

Abstract

Development finance is at a turning point. There is talk about a "triple revolution of goals, actors and tools." As much of Asia grows its way out of poverty, aid will increasingly be focused on Africa and on countries plagued by instability, or with governments unable to meet the basic needs of their populations. A growing share of development finance will be directed to tackling global public goods—like climate change, conflict prevention, and public health. Responsibility for addressing global challenges will increasingly be borne by coalitions that cut across states, the private sector, and civil society. These networks to address poverty and global issues will become a feature of the international architecture in a multipolar world. The rules of the game and the tools of development assistance need to evolve to focus on transparency, results, accountability, a market-driven division of labor and flexible partnerships for the future development finance system to become an effective tool of global problem solving.

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Preface

From our inception, we at the Center for Global Development have been concerned with the analytic and political challenge of making aid more effective. Many of our current and former staff and non-resident fellows—Owen Barder, Michael Clemens, Alan Gelb, Carol Lancaster, Ruth Levine, Todd Moss, Mead Over, Steve Radelet, David Roodman, William Savedoff, Arvind Subramanian, and myself, too—have contributed in this field.

In our working paper series, we normally include only papers by CGD staff and non-resident fellows or papers that we explicitly commission for a particular program. However in our special Innovations in Aid series,* we also publish from time to time papers and essays prepared independently, outside the Center. Our aim is to share as widely as possible analyses in which authors propose new thinking about aid, the aid system, and approaches to operationalizing aid transfers. The focus is on innovations—whether in ideas or operations.

We are delighted to include in that series "The Future of Development Finance" by Nemat (Minouche) Shafik as she moves from her position as Permanent Secretary of the UK Department for International Development to become a deputy managing director at the International Monetary Fund. It is hard to imagine anyone who could have a better perspective today on the changing landscape of foreign aid and on the challenge of innovating in the way aid is delivered.

Shafik highlights a key issue for aid practitioners: donors and recipients need the freedom to take risks, to experiment with new approaches, and to learn from failure as well as success. She emphasizes that evaluation and learning depend on transparency to allow citizens of recipient countries to hold their governments accountable.

The paper is a refreshing assessment from an insider. I urge our readers to take a close look.

Nancy Birdsall
President,
Center for Global Development

*http://www.cgdev.org/section/topics/aid_effectiveness

Innovations in Aid Series

Jean-Michel Severino and Olivier Ray. 2009. "The End of ODA: Death and Rebirth of a Global Public Policy." CGD Working Paper 167. Washington, D.C.: Center for Global Development. http://www.cgdev.org/content/general/detail/1421419/

Owen Barder. 2009. "What Is Poverty Reduction?" CGD Working Paper 170. Washington, D.C.: Center for Global Development. http://www.cgdev.org/content/publications/detail/1421599

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Nemat Shafik. 2011. “The Future of Development Finance.” CGD Working Paper 250. Washington, D.C.: Center for Global Development. http://www.cgdev.org/content/publications/detail/1425068

The Future of Development Finance

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The Pattern and Drivers of Poverty Have Changed

The last decade has seen some of the fastest progress in poverty reduction in human history, in large part because of the rapid growth in China, India and significant parts of East Asia. Eastern Europe has successfully integrated into Europe and Latin America is both growing and beginning to address the huge inequalities that have undermined poverty reduction in the past. At a global level the world is on track to achieve the goal set at the time of the millennium to halve poverty by 2015. Good policies have driven much of this success but well-designed external assistance, debt relief and the massive increase in private capital flows to emerging markets have all contributed to progress.[1] Since 1970, average global life expectancy has risen from 59 to 70 years, school enrolment has grown from 55% to 70% and per capita incomes have doubled to more than $10,000 in real terms.[2]

The picture of global poverty is changing (figure 1) The proportion of people in poverty is greatest in sub-Saharan Africa (51% living on less than $1.25/day and 60% living on less than $2/day (2005 figures)). The greatest number of poor people are still in China and India who have recently transitioned out of the low income category.[3] India alone still has more poor people (456 million living on less than $1.25/day) than all of Sub-Saharan Africa (with 387 million).[4] Over the next 20 years, presuming India and China continue to grow, about half of the world's poor will be in Sub-Saharan Africa. The remainder will be in countries which are technically middle income but where large parts of the population remain in poverty, often because of social exclusion, caste, race, disability or religion.

In most parts of the world, aid is likely to become a much smaller share of external financing for development. Since the 1990s, (see figure 2) ODA has become less

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[1] Collier and Dollar
[2] 2010 Human Development Report, UNDP
[3] Sumner, Andy (2010), "Global Poverty and the New Bottom Billion," Institute of Development Studies Working Paper.
[4] World Bank (2010), Global Economic Prospects, Washington, DC: World Bank.

important than foreign direct investment and workers' remittances. In future, this trend will only grow and aid dependence will fall for most countries.

Figure 1: Percentage of Population living on less than $2 a day World Bank, World Development Report 2008, 2004 data

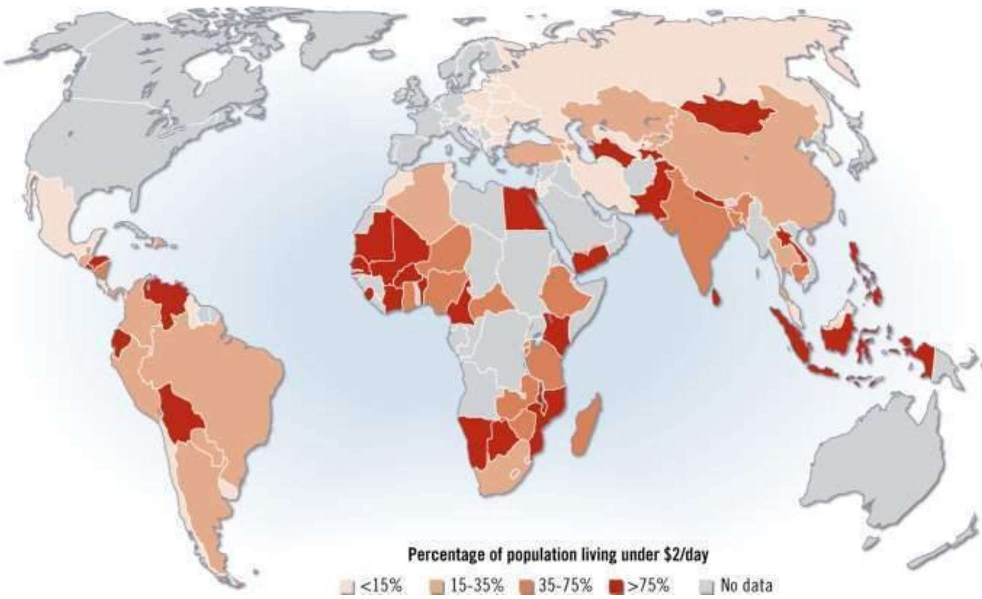
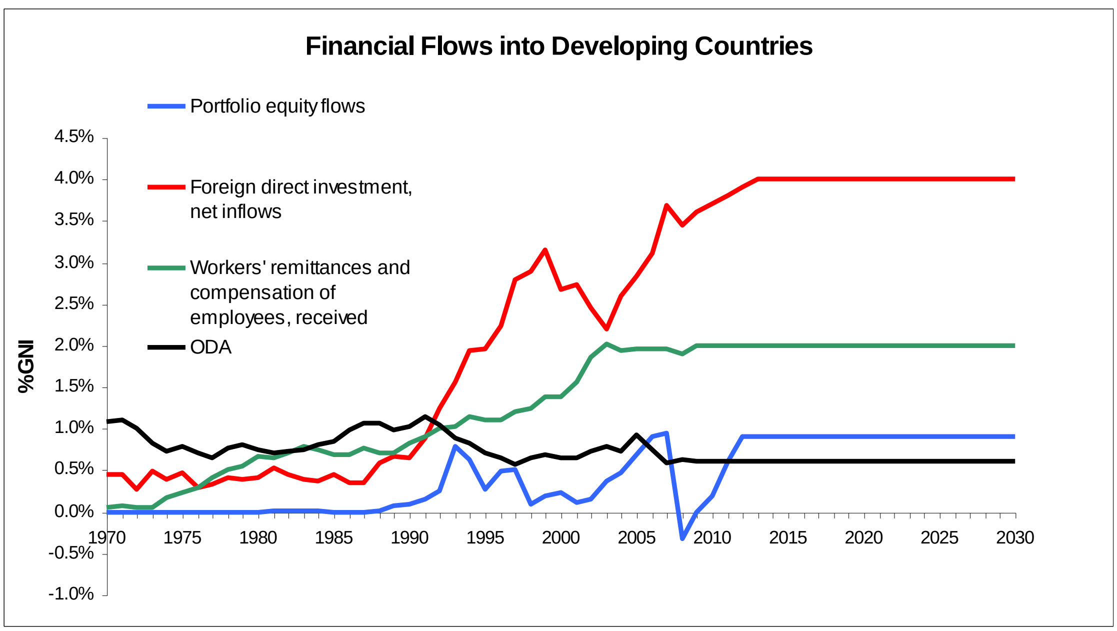


Figure 2: Financial Flows into Developing Countries, IMF World Economic Outlook, 2009



The most intractable poverty will be in states affected by conflict or fragility. 22 of the 34 countries furthest from achieving the MDGs are either in conflict or fragile. These countries, referred to by Collier as "the Bottom Billion", are those where incomes have stagnated as a result of the combined traps of conflict, misuse of natural resources, geographical isolation and bad governance.[5] It is largely in these countries that 25,000 children die every day from preventable causes. Just 47% of the world's population live in countries affected by violence, but those countries account for 61% of the world's impoverished people and 70% of infant deaths.

Goals: The Development Agenda is Broader

These shifts in poverty mean that the purpose of aid is changing. Increasingly aid will have two rationales: (1) international solidarity to help the poorest achieve a minimum standard of living, particularly in states that lack the willingness or capacity to provide it themselves and (2) solving global collective action problems (like climate change, communicable diseases, financial instability, and conflict) that exacerbate poverty and have international spillovers because of globalisation and growing interdependence.

Development strategies are likely to become more ecumenical. Emerging donors will probably continue to blend aid and commercial links but this will be framed in a language of "mutual benefit" rather than mercantilism. Already many in Africa are attracted to Chinese-style state capitalism. The Government of Ethiopia gives much greater priority to achieving rapid development progress than to liberal democracy and civil society. India wants to build a social democracy and welfare state like the Nordic countries but will frame it in terms of universal rights (to work, food, education, and information) given the difficulties of targeting in a nation of over a billion people. Russia will try to spread its economic model to its neighbours using its energy wealth and pipeline network to bind its hinterland together.

More developing countries now have the capacity to shop for development models and partners. The old monopoly of the "Washington consensus" is a thing of the past. When China wanted to build a public healthcare system, it commissioned seven different organisations to present alternative models -- the World Bank, the World Health Organisation, McKinsey and four leading Chinese think tanks. The final proposal – an insurance-based scheme that will be rolled out over the next 5 years – reflects a mix of options that achieves universal coverage and is affordable in the Chinese context. One of the most interesting innovations in development, conditional cash transfer schemes, emerged in Mexico and Brazil and has now spread to dozens of countries across Asia and Africa. Interestingly, these have also been adapted, with many low income countries such as Ethiopia and Kenya opting for unconditional schemes that sustain very poor households above a minimum level of food consumption.

[5] Collier, Paul (2007), The Bottom Billion, Oxford: Oxford University Press.

An increasing number of countries will begin to define development more broadly and account for it accordingly. The Millennium Development Goals (MDGs) will remain important, especially in the poorest countries. But many countries are already beginning to look at wider issues such as environmental sustainability, equity, social capital and rights-based approaches to define their progress. As this occurs, more development assistance will be focussed on these wider issues.

Solving Global Collective Action Problems

By definition, globalisation fosters interdependence. Financial instability, conflict and disease spread rapidly across national borders enabled by the unprecedented mobility of goods, money, people and information. Development cooperation has become a key instrument for addressing the global collective action problems that arise because of globalisation – from agreeing norms on financial regulation to responding to global pandemics like SARs and swine flu to addressing the wider consequences of conflict or climate change. In its early days, aid was seen as something which greased the wheels of diplomacy. Increasingly, aid is becoming the key catalyst for financing global problem solving.

The share of total aid directed at global public goods is likely to rise. One study found the share of aid going to address international and complementary national public goods has already doubled between 1983 and 2003 to a level of 45%.[6] This is controversial since many fear that aid solely focused on poverty reduction and the MDGs will be supplanted by funding for global goods that are more clearly in the interests of taxpayers in richer countries, especially in difficult fiscal times. This tension is epitomised in the pressure to direct aid toward national security objectives which is seen in some cases as prioritising counterterrorism concerns over poverty reduction objectives.

In terms of scale, climate change is perhaps the most important example of this controversy – Nick Stern calls it "the biggest market failure" of globalisation. He notes that in terms of human consequences, the poorest countries will suffer the most because of their limited capacity to respond to the challenges.[7] Estimates of adaptation costs range from $15 billion to $100 billion per year in 2020. Many parts of Asia and Africa face falls in agricultural productivity of up to 50% by 2080 (figure 3).

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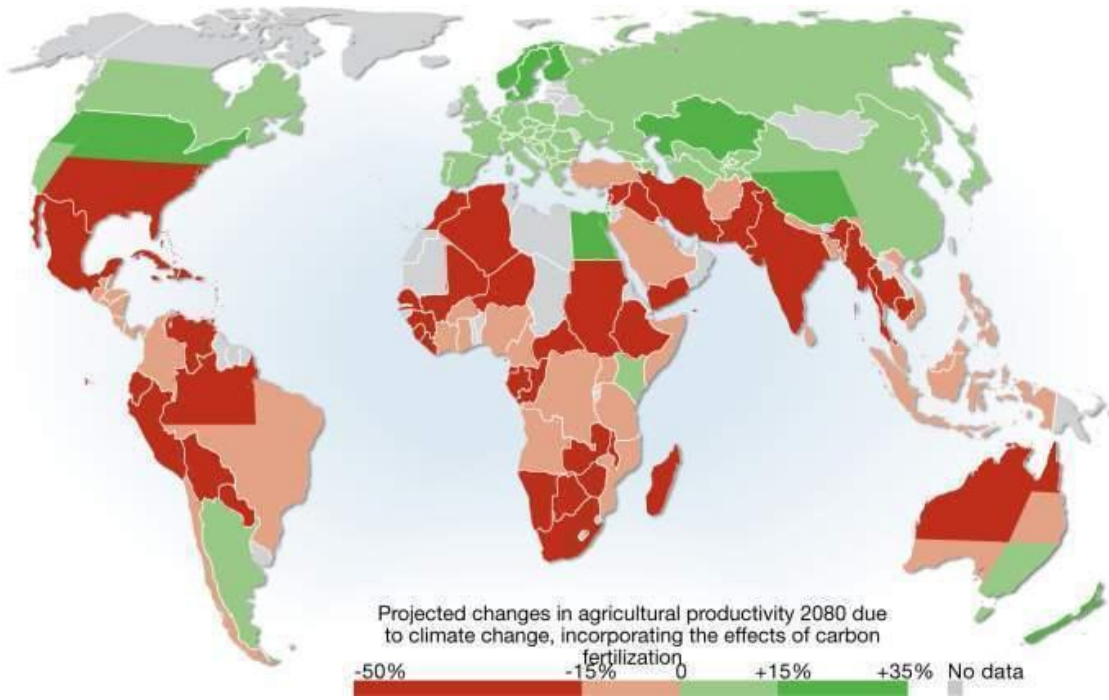
[6] Te Velde, D.W. A. Hewitt, and O. Morrissey (2006), "Aid Financing of International Public Goods: Recent Developments," background paper prepared for the UNIDO project on global public goods for economic development, UNIDO, Vienna. The definition of international public goods here is contentious since some include national spending on education or health that are complementary to global goods.

[7] Stern, Nicholas (2009), A Blueprint for a Safer Planet, London: The Bodley Head, p.30.

Figure 3: Impact of Climate Change on Agricultural Productivity in 2080 2008, Hugo Ahlenius, UNEP-GRID-Arendal (source: WR Cline, 2007, Peterson Institute, Washington DC, USA)

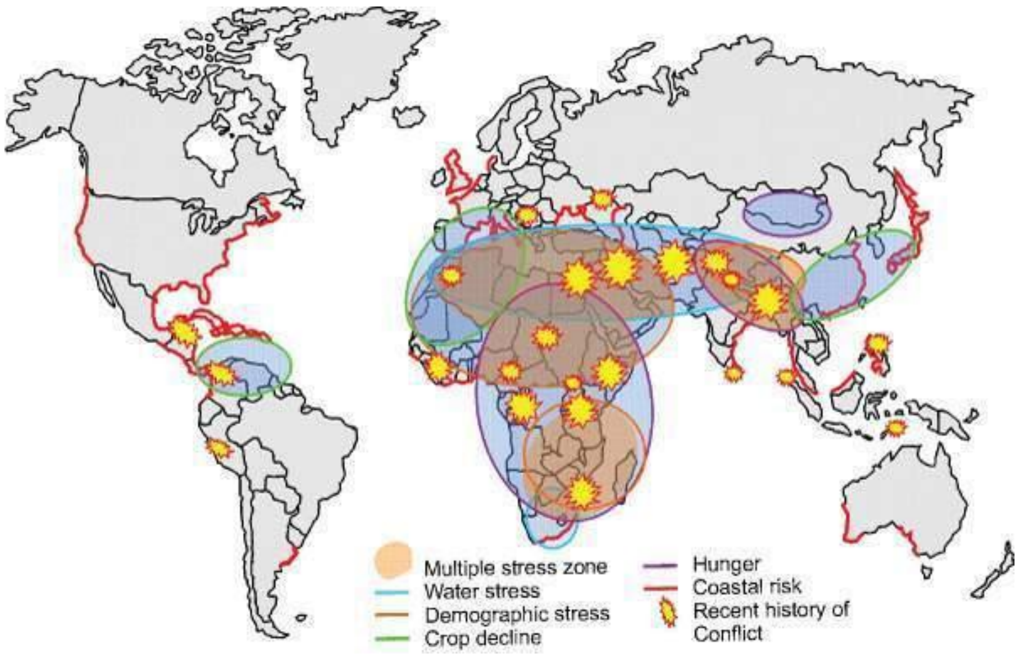


The High-Level Advisory Group on Climate Change Financing showed how it is possible to mobilise $100 billion per year from public and private sources to help developing countries to reduce their carbon emissions and adapt to the adverse consequences of climate change.[8] The debate about climate finance has focused on two contentious issues – additionality and compensation. Developing countries have argued that financing to address climate change should be additional to traditional aid since the costs are additional to those required to achieve the MDGs. Developing countries also argue for additionality on the grounds that the rich countries have developed on the back of high emissions, are responsible for climate change and have filled the world's "carbon space". Rich countries should therefore compensate developing countries for the damage they have caused and pay for the additional costs to them of taking more expensive low-carbon growth paths. Because this is seen as compensation (rather than aid), developing countries want the financing to go through mechanisms that they control rather than through traditional aid channels. Both the additionality and control issues are politically difficult for rich countries facing fiscal constraints and sceptical publics. The agreement at Cancun to set up a Green Climate Fund with a Board that has equal representation of developed and developing countries was rooted in the need to find a way to resolve this tension.

[8] "Report of the Secretary-General's High Level Advisory Group on Climate Change Financing", 5 November 2010.

Conflict is another global collective action problem that is increasingly being seen as something to be addressed by development rather than military intervention alone. It is no coincidence that the parts of the world most at risk of conflict (mainly in Africa and South Asia) are also ones that are poor, have young populations and face natural resource constraints and risks (figure 4).

Figure 4: Stress Zones (DCDC Strategic Trends, 2007)



Collier calls conflict "negative development" since the average civil war leaves a country 15% poorer and, if the consequences to neighbouring countries are included, costs about $64 billion[9]. One civil war destroys as much as total bilateral aid to all countries. There is evidence that investments in conflict prevention work. On average, a £1 investment in conflict prevention saves £4 from conflicts avoided[10]. Similarly, studies on the returns to peacekeeping have shown that UN peacekeeping operations cost much less than other forms of international interventions, while the global peacekeeping budget is only about 0.5% of global military spending. Costs per UN peacekeeper are far lower than the cost of troops deployed by any developed states or NATO[11]. This is also an area where emerging powers such as India (with 50,000 peacekeepers serving in

[9] Collier (2007) , p. 32.
[10] Chalmers (2007), Spending to Save, Bradford University
[11] Durch et al (2003) The Brahimi Report and the future of UN peace operations, The Henry L Stimson Center

30 conflicts around the world) and South Africa, which leads the effort in DRC, make a major contribution.

There is clearly global underinvestment in conflict prevention, peacekeeping and peace building. But critics are suspicious of work on areas like "state building" that can include building security forces, targeting resources at demobilising former combatants, and directing disproportionate resources at areas of conflict. The fear is that these investments are primarily motivated by national security of the donor country rather than the wellbeing of citizens in the aid recipient country. In many cases poverty-focused aid, value for money and national security interests coincide. The tensions will arise when they do not.

Perhaps the most compelling evidence for a more integrated and wider approach to aid is the confluence of climate, pandemic disease and conflict risks in many of the poorest parts of the world. Unless development assistance tries to address these problems together, it is unlikely to succeed (see figure 4).

Actors: Proliferation, Growth and Variable Geometry

Bilateral aid is growing

Despite the economic downturn, global aid has grown by 35% since 2004, both because the agenda has widened and because more players have entered the industry, bringing new dynamism and resources to it. Consider the situation in 1970 when the US, France and the UK alone accounted for three-quarters of official development assistance (ODA) and the Development Assistance Committee (DAC) of the OECD was a small club in which virtually all aid could be coordinated. Today, there are 24 DAC members and affiliates and at least 23 other countries that give aid.[12] Europe has led the way, providing about two-thirds of global ODA between the EU, which has become the largest multilateral aid provider, and European member states, most of whom are committed to reaching the 0.7% of GNI target. Those commitments have had an impact -- countries with more ambitious targets have delivered more aid.[13]

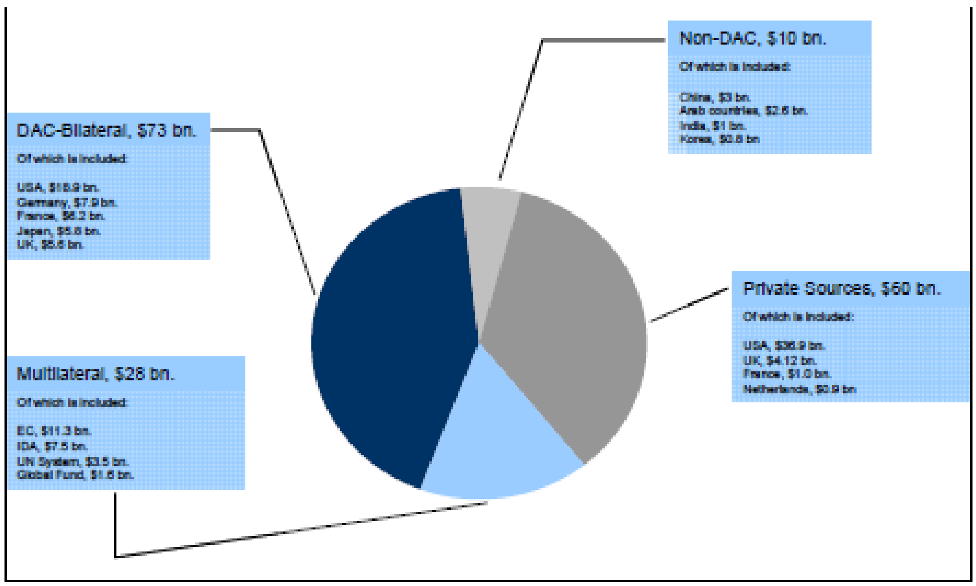
While aid from DAC donors has grown to $73 billion in 2009, that of non-DAC official donors has grown from a very low base to an estimated $10 billion (figure 4). Consistent data on non-DAC donors is hard to come by and definitions are often inconsistent, so comparability is difficult. The largest amounts are probably from China, although it is very difficult to disentangle aid from export credits and foreign investment. There is also a long list of other countries building up their bilateral aid

[12] Kharas, Homi (2009), "Development Assistance in the 21st Century," Contribution to the VII Salamanca Forum, July.

[13] Kharas estimates that the elasticity of aid with respect to GDP rose from 2.25 between 1998-2004 to 5.83 between 2004-2010 in the wake of the G-8 Gleneagles Summit. Kharas, Homi (2010), "The Hidden Aid Story: Ambition Breeds Success," mimeograph, Brookings Institution.

programmes – Russia, India, Brazil, Turkey, and South Africa. These newer donors have an approach that is in some ways more old fashioned (aid is a tool of foreign policy and pursuing commercial/mercantilist objectives) and in other ways very progressive (it is a partnership of equals based on "South-South cooperation", not burdened by colonial history and not fraught with conditionality). As their aid programmes grow, they will change the terms of the debate about development assistance.

Figure 5*, OECD/ DAC The Index of Global Philanthropy, 2009 and Kharas, 2009*



Source: OECD/DAC, *The Index of Global Philanthropy 2009*, and Kharas (2009)

The Arab donors are a special case since they are well-established, providing aid flows averaging 1.5% of GDP (more than double the UN target of 0.7% and five times the OECD average) since the 1970s after the first oil price shock. Arab aid, 90% of which comes from Saudi Arabia, Kuwait and UAE, represents 13% of DAC ODA and nearly three-quarters of non-DAC ODA. Arab aid is untied, tends to be very country-led, highly concessional, inversely correlated with the oil price, and not burdened by conditionality. Arab donors are highly harmonised with each other, but less so with other donors, although this is evolving with greater collaboration with DAC donors.[14]

Multilateralism alongside Minilateralism

The multilateral system too has grown to $28 billion in 2009, although there is less universalism and more "minilateralism" – small groups of countries partnering to create

[14] In recent years, Arab donors have widened their geographical focus beyond neighbouring and Muslim countries and have broadened their sectoral focus beyond infrastructure. For further details, see World Bank (2010), "Arab Development Assistance: Four Decades of Cooperation," Washington DC.

an institution to address a particular issue or set of issues.[15] Kharas (2009) estimates that there are over 263 multilateral aid agencies including the major development banks, the UN system (which now provides only 4% of global ODA), and a large number of specialised funds, often delivering aid around a set of narrower development objectives (like HIV, vaccines, or disaster prevention). In addition, there are a large number of informal groupings such as the various “G clubs” (G8, G20, G22, the BASIC group, etc) that operate alongside the formal multilaterals but can have a major impact on global decision-making.

The share of global aid going to the more universalist institutions with wide global membership – like the UN and the World Bank – has declined to be supplanted by the growth of more specialised institutions such as the Global Fund to Fight Aids, TB and Malaria and networks like the Extractive Industries Transparency Initiative. Rischard argues that these “global issues networks” provide an important addition to global governance and problem-solving that has the advantage of speed, flexibility and legitimacy.[16] Initially some of these global or “vertical” programmes were about coordination and standard setting, but they are increasingly about delivering results by directing funding through developing country governments or other development agencies. They have also increasingly served as a way to include non-official donors, such as the foundations and corporations, in common endeavours.

The international architecture is not a product of “intelligent design” but instead is evolutionary. The evolution over the last decade of this wider array of minilateral institutions reflects frustration with the effectiveness, legitimacy and pace of delivery in many of the multilaterals. As objectives diverge, more countries are choosing not to compromise through multilateral governance structures.[17] They have also increasingly stressed the need for multilaterals to reform their governance and modes of operation if they are to remain important for solving global problems (hence the massive effort to reform the governance of the IMF and the World Bank and the ongoing debate about Security Council reform).

Over time, money and influence have drifted toward the more effective parts of the multilateral system. Many poorly performing agencies have seen funding levels stagnate in recent years as donors have increasingly focused their resources on those that are better at delivering and accounting for results. Politically, this has proven far easier than withdrawing or attempting to close down ineffective multilaterals. The UK has just completed a review of 43 multilateral institutions that assesses their performance against a range of criteria and has signalled that funding will be linked to

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[15] Naim, Moises (2009), “Minilateralism: the Magic Number to Get Real International Action,” Foreign Policy, July/August.

[16] Rischard, Jean-Francois (2002), High Noon: Twenty Global Problems, Twenty Years to Solve Them, Basic Books.

[17] Powell, Andrew and Matteo Bobba (2006), “Multilateral Intermediation of Development Assistance: What is the Trade-off for Donor Countries?” InterAmerican Development Bank Working Paper, June.

these assessments. Publishing the results of this multilateral aid review is likely to influence the decisions of other donors as well.[18]

Private Philanthropy and Civil Society

There are no reliable estimates of private giving to development causes but one recent estimate is around $49 billion per year, and possibly as high as $60 billion.[19] The largest is the Gates Foundation with a total asset trust endowment of $36.4 billion and annual disbursements of $3-4 billion. But the fastest growing part of the sector are the numerous small foundations that are expanding in every part of the world[20].

Similiarly, there is no reliable estimate of the number or scale of civil society or faith based organisations that support development causes. They easily number into the millions of organisations. They vary in scale to those run by individuals to the modern international NGOs that are organised like multinational corporations with strong global centres and many national affiliates.

Modern Global Governance is Networked

So how does this new web of aid come together? A good example is the MDG Summit in New York in September 2010. Increasingly these global events operate in two parallel universes. There is the traditional multilateral part at which heads of state from donor countries read prepared statements about their official aid and those from developing countries describe their needs. But alongside this, networked minilateralism is in full swing in a variety of parallel events that mix Ministers, civil society, corporations, private philanthropists and celebrities.

This is illustrated by an event that the UN Secretary General hosted on 22 September 2010 on maternal and child health – two key millennial development goals that are off-track. The "Summary of Commitments" documents more than $40 billion of promises over a five year period to improve maternal and child heath. It is striking in a number of respects:

- For the 35 countries in attendance, the resources and policy commitments announced by developing countries were as substantial as those presented by rich countries. For example, Bangladesh committed to doubling the percentage of births attending by skilled health workers from 24.4% through training an additional 3000 midwives and upgrading 59 district hospitals and 70 mother and child welfare centres. Ethiopia committed to a fourfold increase in midwives,

[18] For details, see Multilateral Aid Review, www.dfid.gov.uk, March 2011.
[19] Hudson Institute (2009), Index of Global Philanthropy, Washington DC.
[20] Green, Mike and Matthew Bishop (2009), Philanthrocapitalism, London: AC Black.

with the objective to reduce maternal mortality from 590 per 100,000 to 267 and under-five mortality from 101 to 68 by 2015.

- 54 civil society organisations also made commitments. The foundations' promises ranged in size from $1.5 billion from the Gates Foundation to $5 million from a local Nigerian Foundation. Major civil society organisations like CARE and Save the Children made large financial commitments ($1.8 billion and $500 million respectively over a 5 year period), but many smaller NGOs made commitments around advocacy, standard-setting, and lobbying for legislation.
- Private sector offers were also substantial. Merck committed $840 million over five years for HIV prevention and treatment, childhood asthma programmes, and donations of a vaccine for human papaloma virus. Johnson and Johnson donated 200 million doses of treatment for intestinal worms in children, a major cause of poor school attendance. The Body Shop initiated a $2.25 million programme to stop sex trafficking of children in 60 countries.
- The multilaterals (WHO, GAVI, Global Fund, UNICEF, UNAIDS and the World Bank) focused on providing a coordinated mechanism/platform for delivering common objectives.
- In addition, a large number of associations, such as the International Confederation of Midwives and the International Paediatric Association, endorsed the programme of action and committed to have their members support it.

This is what modern global governance looks like -- a coalition of multilateral institutions, national governments, civil society and the private sector coalescing around issues of common concern. As the power of national governments declines, the importance of such networks and alliances will only grow. Will such a fluid and dynamic structure deliver better outcomes? Only if some of the ways of working in the aid industry change.

Rules and Tools: We need New Ones

Aid will continue to increase in the long run, even though it will be a declining share of total flows to developing countries. The fastest growth will be among new donors and private philanthropy. The delivery of aid will be increasingly fragmented, using multiple delivery channels with various combinations of donors and recipients - government, private foundations, corporations, civil society, and individuals. These will create a complex web of networks and alliances to achieve various objectives.

There are several risks to this new world of aid. Fenglar and Kharas (2010) identify the risk of growing fragmentation as more and smaller donors enter the aid market. In 1996, there were 17,102 aid projects registered with the OECD DAC; in 2008 that number was 99,376. The average size of each activity fell over the same period from

$2.92 million to $1.59 million.[21] The administrative burden is huge – they estimate that official donors sent more than 30,000 missions to developing countries to manage aid projects. Coordination costs for developing countries are vast. Weak institutions are burdened or have good staff poached from them by donors. The examples are well documented and widespread.[22]

Many developing countries have greater capacity to shop for and manage development partners. This is a positive thing – but they need to be given the tools to do this well. There are three elements to this: (1) new rules around transparency, benchmarking and independent evaluation; (2) new tools that deliver results and flexible financing especially for global public goods; and (3) a division of labour driven by "market-like" forces or a "collaborative market" in the aid industry.

New rules

For such a large and fragmented aid industry to work, there is a need for much greater information, freely available, to allow participants (donors and aid recipients, especially citizens) to coordinate, plan and implement more effectively. Transparency is starting to take hold in the official aid industry, albeit slowly. The International Aid Transparency Initiative is a good example, where 18 donors have agreed to publish information on their activities based on a common reporting format, allowing them to be quickly and easily compared and held more readily to account[23]. The UK has launched a Transparency Guarantee, committing to publish comprehensive and comparable information on all development spending, which is accessible to citizens in the UK and overseas.

Transparency needs to spread to other parts of the industry, including civil society, emerging donors and the private philanthropies and corporate sector. Many of them have been reluctant, but clearly they are the new frontier for the transparency agenda. Inevitably, money will flow to the better performing agencies in the system (so it should be no surprise that the poorly performing ones are the most resistant to transparency).[24]

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[21] Fenglar, Wolfgang and Homi Kharas (2010), Delivering Aid Differently, unpublished manuscript.

[22] For more examples, see Owen Barder, Simon Maxwell, Mikaela Gavas, and Deborah Jackson (May 2010), "The Governance of the Aid System and the Role of the EU," http://www.odi.org.uk/resources/details.asp?id=5075&title=global-governance-aid-system-role-european-union-eu.

[23] For more details, see http://www.aidtransparency.net/. It is important to note that there have been several other attempts to coordinate data on aid. "AIDA" was an early effort by the World Bank to get coordinated reporting on aid activities through its Development Gateway (see AidData.org). Most of these efforts have has difficulty sustaining input and keeping information current.

[24] For example, DFID has used delivery of results to allocate its aid across countries and the multilateral system for the first time this year.

Transparency enables a wide variety of analysts across the world to begin to benchmark different agencies which can then drive improvements in performance. These analytical intermediaries are essential for transparency to have an impact, especially in developing countries where there is less capacity. An interesting example is an assessment of aid quality by Birdsall and Kharas which looks at 30 performance indicators for 23 countries and selected multilaterals.[25] This can be complemented by growing independent evaluation, including impact evaluations based on randomised trials, that enable the aid industry to learn more systematically from experience. Most importantly, transparency will enable citizens in developing countries to hold governments to account, to exercise their rights and to have greater control over decisions that affect their lives.

Better Tools

If donors continue to use old-fashioned aid tools such as projects, project implementation units, foreign consultants, and accountability to foreign capitals, this new aid architecture will collapse under its own weight and ineffectiveness. New tools are needed that encourage pooling of resources, clarity on results, using more local capacity, and greater transparency and accountability, especially to beneficiaries. These more modern tools of development have to move from being interesting innovations, to becoming a much bigger share of development activity.

There are many good examples of more modern tools currently in operation. Severino cites the example of the Consultative Group to Assist the Poorest which brings together all the major actors in the microfinance industry (donors, banks, NGOs, etc.) to agree common standards, invest in new products, report transparently on financial performance, and build market infrastructure like rating agencies and accounting tools to enable the industry to grow.[26]

Many donors (including DFID) are experimenting with results-based financing. For the first time ever, all of DFID's bilateral programme for 2011-2014 (roughly £20 billion or $32 billion) has been allocated based on results offers competitively bid by country offices around the world.[27] This will allow far greater clarity about what outcomes will be achieved with aid money as well as greater attention to value for money. Within those programmes, DFID is funding several large results based financing schemes at the national level in health, education, water and sanitation. This includes experiments with

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[25] Birdsall, Nancy and Homi Kharas (2010), "Quality of Official Development Assistance Assessment," Brookings Institution and Center for Global Development, October.

[26] In the interests of transparency, I should reveal that I chaired CGAP from 2000-2004. But the praise for the CGAP model comes from Severino and Ray (2009).

[27] Birdsall, Nancy (2011), "Wow: Will this Results-Based Approach Change DFID's Country Allocations?", http://blogs.cgdev.org/globaldevelopment/2010/12/wow-will-this-results-based-approach-change-dfid-country-allocations.php, Center for Global Development. Also see DFID.gov.uk – findings of the Bilateral Aid Review (available from 1 March 2011).

results-based approaches in health in Uganda, in climate change in Nepal and India and the first pilot of cash-on-delivery aid in the education sector in Ethiopia.[28]

New technologies also enable new models for delivering aid. The rise in person-to-person technologies via the internet has shortened the accountability chain between taxpayers in rich countries and beneficiaries in poor countries. It is now possible for private individuals to select beneficiaries in poor countries and to give them a grant or a loan while having an independent agency monitor progress.[29] Smart cards have made it possible to provide financial services and cash transfers to isolated communities where it would have been inconceivable to provide branch banking in the past. Institutional links between rich and poor countries – through businesses, hospitals, schools and universities – will grow, reflecting the desire of many people in better off countries to engage with the developing world.

Financial innovations have also changed the landscape for mobilising resources from the private sector and citizens. The International Finance Facility for Immunisation used bond markets to front-load funding for immunisation and has successfully mobilised $3 billion[30]. The voluntary tax on airline tickets funds 72% of UNITAID's $600million annual budget, which contributes to scaling up access for treatment of HIV, tuberculosis and malaria in developing countries[31]. Flexible mechanisms that finance both public sector and private sector financing have been necessary to address the challenge of climate change. The Climate Investment Funds, Clean Technology Fund, Adaptation Fund, Clean Development Mechanism, and the new Green Fund agreed in Cancun reflect the need to provide multiple financing windows to meet the preferences of different donors, recipients and investors.

Division of Labour and Practical Partnerships

The aid industry has tried to improve its division of labour for over a decade. The "Paris Declaration" followed by the "Accra Agenda" were valiant attempts to harmonise ways of working that would improve the effectiveness of aid. The European Union also tried to agree a division of labour at country level with every member state agreeing to limit the number of sectors in which it would be active. These efforts have not been able to keep up with the growth of the industry and the proliferation of players – a new model for increasing effectiveness and rationalising the industry is needed.

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[28] For more detail, see Brook, Penelope and Suzanne Smith (2001), Contracting for Public Services: Output-based Aid and its Applications, Washington, DC: World Bank and Birdsall, Nancy and Willian Savedoff (2010), Cash on Delivery: A New Approach to Foreign Aid, Washington DC: Center for Global Development.
[29] See, for example, Kiva.org.
[30] http://www.iff-immunisation.org/bond_issuances.html
[31] http://www.unitaid.eu/en/UNITAID-Mission.html

Given the growing scale, it is more likely that competition and a more practical approach to partnerships, rather than coordination, will drive improvement. Transparency and pressure to deliver results will mean that more donors will have to focus on their comparative advantage and work in a more business-like fashion with partners who can deliver. A more competitive aid market will need rigorous testing of new ideas, freedom to experiment and to fail, and mechanisms for learning and improving. Barder argues for a "collaborative market" where proliferation forces greater specialisation among donors.[32] It would be impossible to negotiate a clear division of labour and to create agreed structures to coordinate it. But the logic of comparative advantage could drive a process whereby more donors find their competitive niche and partnerships emerge that are less about including everyone and more about having the organisations around the table you need to deliver an outcome. In many areas, such as global health and climate change, the private sector may play the major financing role in future while public financing is more about leverage public goods.

One illustrative division of labour that focuses on the unique characteristics of different actors might look like the following:

United Nations: No other organisation has the legitimacy that comes from universal membership. This makes the UN uniquely placed to be the leading agency on politically sensitive issues like conflict, peace and security, humanitarian matters, peacekeeping and peace-building. In those contexts where national governments are often weak, the UN has to play an important role in coordinating the activities of international actors (such as through the cluster system in humanitarian crises). Its universal membership also makes it an ideal place to agree many global norms and standards (maritime rules, global health standards, etc.). The UN has many able competitors in the delivery of more conventional development programmes.

World Bank and the Regional Development Banks: The international financial institutions are best positioned to lead on large scale development finance in states that can afford to borrow and have the capacity to manage programmes on their own. They could be the major source (along with private capital markets) of funding for middle income countries with major poverty issues (such as India, Brazil, Indonesia) as well as well-performing low-income countries (Ghana, Vietnam, Tanzania). The regional banks have a unique role to play on regional integration issues.

Bilateral Agencies: Grant financing will remain important to supporting delivery of basic social services in many low income countries for many years ahead. Bilateral donors who face strong taxpayer pressure to deliver tangible results have a comparative advantage in funding education and health services in the poorest countries, particularly in fragile states where they can work alongside the UN. For now, new bilateral donors

[32] Bardar, Owen (2010), "Could donor proliferation lead to better aid?", http://www.owen.org/blog, November 23.

are likely to focus on aid financing facilitation of commercial links and technical assistance (such as China's tradition of sending doctors to Africa or Brazil's sharing of its experience on treating HIV or managing cash transfers) where their recent experience is often more relevant to their partners. Most bilateral agencies will be the repository of national support for global problem solving such as funding for climate finance, global health or conflict prevention, reconstruction and stabilisation.

Foundations: Private philanthropists can afford to take risks that public funders cannot. They have a huge comparative advantage in being the "venture capitalists" who invest in development innovation. This can include technology (such as the Gates Foundation's investments in new vaccines) but can also include innovations in delivery mechanisms, accountability, and programme design.

Civil Society: In all countries, civil society groups have a unique role to play in holding governments and, increasingly, the private sector to account. In many contexts they empower disadvantaged groups to demand and exercise their rights. They also deliver essential services where states cannot operate or where governments choose to deliver services through them.

It is possible to imagine that partnerships will increasingly be built on the basis of the comparative advantages of organisations as described above. This is already apparent from the division of labour in partnerships like those on maternal health and emerging views on the architecture for climate finance.

What will the future look like?

This paper is not meant to be predictive – it is intended to identify major global trends and raise issues which need to be resolved. Most developing countries will rely primarily on their own resources and private capital flows to finance their development and they will have more choices about funding sources than ever before. Nevertheless, flows of development finance from richer countries to poorer ones will only grow in the years ahead. In addition to financing poverty reduction, those flows will increasingly be about addressing global public goods. These aid flows will move through a networked web of national, international, private and public channels that will increasingly compete and work in utilitarian partnerships that evolve depending on the issue at hand.

By the time the MDG target date of 2015 is reached, the world will need to coalesce around a new framework for thinking about development. A new global framework is likely to draw on the MDGs but also include wider issues such as conflict and climate change. There will also be an expectation that the responsibility for global problem solving is borne more widely to include emerging powers, the private sector and civil society. Arguably, thinking about aid as part of global citizenship provides a whole new rational for the 0.7% ODA/GNI target. To make this new architecture work, we will need to redefine the rules, tools, division of labour and partnerships that govern financing for development. It is imperative that we use the next few years to agree a new set of principles around the wider objectives and modalities of aid that will underpin a far more complex development scene. If we get this right, the future of aid will be to serve as the major tool for addressing the global challenges of our time – peace, poverty and environmental sustainability.