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Research Report

The financing of development cooperation at the United Nations: why more means less

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The Financing of Development Cooperation at the United Nations: Why more means less

Summary

Changes in the financing of United Nations development cooperation (UN-DC) are gradually eroding the multilateral character of UN development aid. Two trends have become clear over the past 15 years. First, donors have more than doubled their financial contributions for UN development cooperation. Second, the character of these contributions has fundamentally changed: while the share of "core financing" – i.e. funding for the multilateral mandate of the UN's 37 operational agencies – has been shrinking for years, contributions earmarked for specific locations and issues – thus resembling bilateral contributions – have skyrocketed. The balance between the two types of financing is thus shifting, and the result could be a major makeover of the system as a whole.

Global development challenges such as climate change require concerted action among nations in today's networked world. Of itself, the UN's universal membership offers a highly appropriate multilateral framework for this purpose and gives its development system a special legitimacy, which also extends to setting norms and standards. But current financing practices are putting pressure on UN development cooperation: more and more, donors are bilaterally earmarking contributions for projects that they prefer, thus profiting from the UN "brand" without directly contributing to the cost of its multilateral mandate in the form of core contributions.

The problem is aggravated when competing UN agencies

offer financial incentives which encourage potential donors to expand their "bilateralized" portfolios. Given that these incentives are subsidized from core budgets, the provision of future core contributions thus becomes less attractive to donors. Complete bilateralisation of the UN-DC therefore becomes a plausible scenario if current development trends continue to result in a downward spiral of dwindling core contributions.

Clearly, something must change. Unfortunately, individual donors have few incentives to make a fundamental change in their behaviour.

One way to prevent a mass movement of donors onto the bandwagon of bilateral earmarking would be a 'codex of good donorship' which should rest on three pillars:

- a "critical mass" of core funding with respect to each donor's financial wherewithal;
- a system-wide obligation of full recovery of costs for programme support and management regarding earmarked projects, with standards for cost classification to be used by the Secretariat for monitoring; and
- financial commitments for 3-5 years instead of the present practice of annual stop-and-go support for long-term development processes in programme countries.

Negotiating such a codex should be one of the first tasks of the newly founded Global Partnership for Effective Development Cooperation, whose steering committee consists not only of traditional donors, but also of emerging powers and UN agencies.

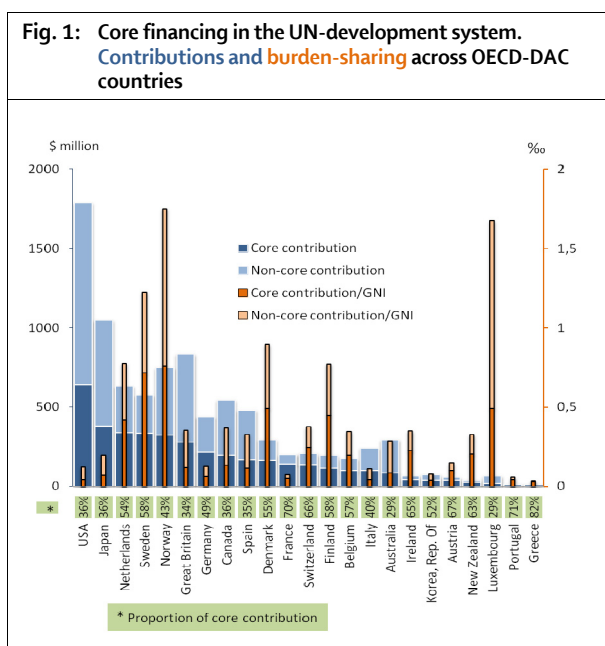
UN-DC financing – two sides of the same coin

The UN Development Programme (UNDP) has served as a central financing clearing house for much of the UN's history. Nowadays, however, individual UN agencies for the most part mobilize resources directly without the mediation of a central organization. The consequences for the UN development system have been far-reaching and not always positive.

Proponents of the decentralized approach to resource mobilization argue that it allows UN agencies to directly approach donors to get support for specific programs. At the same time, however, this approach steps up competition between individual UN agencies. Mobilizing resources is both an opportunity and a necessity for individual UN agencies, which also then have an incentive to push their own visibility and set themselves off against the competition. To make things worse, competitive behaviour not only affects operational entities with similar mandates, but has now also spread to specialized UN agencies whose task is primarily to set standards – such as the World Health Organization (WHO) and the International Labour Organization (ILO).

Two trends characterize the long-term development of UN-DC financing:

- Quantitative growth:** Over the past 15 years (1995-2010), the absolute volume of both core and earmarked contributions to the UN development system has more than doubled, to 15.5 billion USD. There are indications, however, that the financial crisis has affected the level of contributions in 2011.
- Qualitative change:** The quality of contributions to the UN development system has also changed during this time. In particular, the share of core financing has plummeted for years as earmarked funding skyrockets. In 2010, core financing only made up 30 per cent of contributions compared to 63 per cent in 1995, and the absolute volume of core financing is expected to drop in 2011.



When is UN development aid multilateral? Two viewpoints

The OECD defines multilateral contributions as commingled donor funds which lose their bilateral character through pooling and become an integral part of the services performed by an international agency focusing on development. In contrast, earmarked funds are designed to make the UN more pliable for national interests and priorities; this hybrid character is why they are sometimes called "multi-bi" funds. The Organisation of Economic Cooperation and Development's Development Assistance Committee (OECD/DAC) therefore logically does not count earmarked contributions as multilateral aid for the UN development system.

Unlike the OECD, however, the UN Secretariat expects multilateral development aid to have a broader design. UN agencies use concepts and definitions adapted to their individual needs; there are currently no system-wide standards. There are also clear differences in the degree of earmarking; while most donors earmark their contributions restrictively, such as for a certain project in a given country, there are also positive counterexamples with fewer restrictions, such as funds made available merely for thematic issues or sectors (soft earmarking).

Quality criteria for contributions to UN-DC

Donors, UN agencies, and recipient countries assess the quality of financial contributions to UN development cooperation in different ways depending on their particular standpoints. To be effective and efficient in the use of funding in line with their multilateral mandate, UN agencies need contributions that

- have volumes based on actual financial need,
- are predictable and paid on time,
- can be used for all expense categories within the mandate's limits,
- are easy to manage administratively, and
- correspond to the organization's mandate.

Creeping "bilateralisation" of multilateral UN-DC?

How are current financing practices for the UN development system to be assessed on the basis of these criteria?

1.) Incoherence between mandate and funding: The UN development system was created in the second half of the 20th century as a reaction to emerging problems in member states. Overall, the system has a comprehensive, differentiated mandate which often makes it difficult, if not impossible, to objectively determine the budget needed for implementation. The volume of contributions depends on a variety of factors; in addition to reports of need in strategic plans presented by UN agencies, donors also have financial and domestic-policy restrictions. Therefore, it has often been argued that financing for the UN development system must at least be in line with increases in official development aid (ODA).

2.) Financial contributions fluctuate greatly: Generally, most donors only commit contributions for annual periods, so the UN development system is faced with a high degree of unpredictability of funding flows, which is usually greater for earmarked contributions than for core contributions. In addition to erratic donor behaviour, fluctuations in exchange rates add to the problem. The difficulty that UN agencies face lies in ensuring that their program activities are realistically and adequately conducted despite insufficient information about basic planning parameters. After all, a planable, predictable inflow of funds is indispensable for the greater focus on effectiveness called for by the agencies' governance boards.

3.) ... can only be used to a limited extent: By definition, UN agencies can only use core financing contributions for any aspect of program implementation at their discretion. This funding is therefore used not only for programmatic work but also for in-house administration and for such elementary processes as knowledge management, which enable the valuation of earmarked funding to begin with – and thus benefit all donors. An inordinately large share of core contributions is used to cover these costs (see Box 1). The burden is spread very unevenly, with 10 OECD countries contributing some 65 per cent of core financing – and therefore facing pressure to justify their action to their constituencies.

4.) ... entail a lot of red tape: Transaction costs increase whenever rules and deadlines (have to) differ from those set forth internally by UN agencies. Depending on their specific design, earmarked contributions therefore increase the amount of red tape. For instance, the WHO has to produce some 5,000 separate project reports each year.

5.) ... do not always comply with the mandate: Because it concerns the essence of multilateralism, the issue of the alignment of earmarked funding with mandates is politically sensitive. A report by the Secretary-General speaks of an "indirect" relation between earmarked funding and the mandates, guidelines, priorities, and targets of the various governance boards at UN agencies "in the best case." Earmarked funding regularly encourages UN agencies to expand their activities at the margins of their mandates, which in the end undermines the oversight capabilities of the multilateral boards. At the same time, the funding intentions of the donor community already played an important role back when the UN agencies were founded, so that the national interests of bilateral donors have always been part of the UN development system.

In conclusion, earmarked funding generally complies only in part with the quality criteria for contributions to the UN-DC in the best case. In light of this "creeping bilateralisation" of the UN development system, the General Assembly has confirmed in a number of resolutions that core financing "continues to be the bedrock" of UN development cooperation. Earmarked funding can be helpful as a supplement and is not problematic in itself. Nonetheless, its current prevalence is aggravating target conflicts between

bilateral and multilateral priorities in UN development cooperation, for example in areas such as family planning and global labour standards.

Box 1: The need for full-cost recovery of programme support and management costs

In addition to donor behaviour, the trend towards earmarked contributions also has an internal UN dimension. When competing for financial support for earmarked project funding, UN agencies charge administrative fees that do not cover all of their costs; core contributions therefore cross-subsidize these projects. The effects of these subsidies are increasingly making themselves felt. At present, a third of core contributions goes to programme support and management costs – compared to only around 10 per cent of earmarked funding. The UN's Joint Inspection Unit estimated that donors of earmarked funding would have to be charged more than twice as much for these administrative costs to be recovered than is currently the case. The competition for donor funding thus threatens to become a 'race to the bottom' when it comes to administrative fees for UN development cooperation. The more administrative overhead for earmarked projects has to be covered by core contributions, the less attractive the provision of core contributions will be for donors in future.

Solutions

Major donors have understood the challenges discussed here for quite some time and a number of General Assembly resolutions state that current financing practices are no longer tenable. Nonetheless, little has been done. At the country level, one possible solution would be to centralize the resource mobilization function through the UN resident coordinators as part of the "Delivering as One" initiative. But the challenge ultimately seems too fundamental to be solved by any single change. Instead, a bundle comprising the following promising incremental and structural measures covering various approaches, could be a solution:

- a) **Improved quality of earmarked contributions:** Nearly 90 per cent of earmarked funding is restrictively earmarked by individual donors for specific projects, which means that there is tremendous potential for multiple donors pooling their contributions. Moreover, soft earmarking could also be ramped up. The governance boards at UN agencies would have to adopt technical rules to this end, and donors would have to pledge to take part.
- b) **Implementation of differentiated administrative costs:** This technical proposal basically aims to reverse the current incentive structure by charging a lower administrative fee for core contributions than for earmarked funding. Such an approach would have to be launched at the system-wide level for it to have the desired effect - instead of leading to further competition.
- c) **A minimum amount of core contributions:** Another proposal goes even further – the governance boards of

UN agencies would reach agreements with donors about minimum core contributions in order to attain a "critical mass" of multilateral development aid. Up to now, donors have not shown much interest in such a change, partly because many of them do not contribute commensurately with their economic capacities (see Figure 1). Simply converting earmarked funding to core contributions would of itself lead to great improvements, largely without affecting overall volumes. But the call for a greater share of core financing is also sensitive because a number of donors believe that UN development cooperation needs to be more cost-effective and focus more on results. In that sense, earmarked funding is seen as a means to highlight these weaknesses and may even be taken as a call for the worst effects to be remedied. Nonetheless, current financing practices run counter to reform efforts within UN agencies aimed at improving the results-orientation.

- d) **Long-term contribution promises:** This far-reaching proposal would fundamentally change the financing system – based on the model of the World Bank, for instance – by implementing a multi-year pledging mechanism via donor conferences.

- e) **New financing options:** Other proposals have also been made, although they seem politically less feasible, such as a global tax on financial transactions (Tobin tax) or a carbon tax on air traffic to provide a constant, independent source of (core) financing. There are, however, no precedents for the shift of sovereignty to the supranational level that would be needed here.

Conclusions

A decentralized financing system always entails the risk of imbalances in resource allocation which can result in donor "orphans"/"darlings" for certain issues or geographical areas. UN development cooperation has always helped to ensure a balance, but the creeping insignificance of core financing is hollowing out the multilateral UN development system, so that this crucial function increasingly is being enervated. The combination of normative and operative work within the UN development system is unique in international development architecture and serves as a basis for holistic, long-term development policy work. If UN development cooperation is forced to sell itself as a mere "implementing organization" for bilateral programs, it will fall far short of its potential.

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