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Research Report

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Earmarked Funding for Multilateral Development Cooperation: Asset and Impediment

Summary

Multilateral cooperation means that states can collectively achieve more than they can through individual and bilateral efforts alone. Multilateral organisations are important instruments for this: they have a greater geographic and thematic reach, operate at a larger scale and stand for multilateral norms and values. Funding provides an important basis for multilateral development cooperation – only with sufficient core funding at their disposal can multilaterals effectively and independently perform the functions member states expect. This includes a problem-driven allocation of resources, strategic orientation, and flexibility in the implementation of and advocacy for internationally agreed values, norms and standards. The coronavirus (COVID-19) pandemic has demonstrated the need for international cooperation to deal with multiple crises that affect all societies. It has also proved the value of multilateral organisations that can combat the spread of COVID-19 worldwide and support countries where health systems are weakest.

Over the last three decades, the funding trend for multilateral organisations has been towards ever greater shares of earmarked funding, whereas core funding has grown much more slowly or has even declined for some organisations.

A contribution is earmarked when a contributor directs it to a specific pooled fund, programme or – most typically – a project in a specific country. The substantial increase in such earmarked (also “restricted”, “bi-multi”) funding has certainly buoyed organisations and helped to close many funding gaps.

However, such atomised funding practices come with the risk of instrumentalising multilateral organisations for project implementation purposes, and by doing so, reducing

their programmatic coherence, effectiveness, efficiency and legitimacy. For contributors, earmarking has often been a politically convenient choice. It provides them with control over the use of their resources and visibility for results achieved, all at attractively low implementation costs. However, both the direct implications of earmarking for specific interventions and the more systemic effects on the effectiveness and efficiency of the multilateral organisations tend to be overlooked. At the scale we see it today, earmarking may actually undermine the ability of multilaterals to fulfil the member states’ expectations and make full use of their unique assets to advance the 2030 Agenda for Sustainable Development.

To fully harness the potential of multilateral development cooperation, both member states and multilateral organisations have to change course.

- A larger number of contributors – also beyond the Organisation for Economic Co-operation and Development/Development Assistance Committee (OECD/DAC) – should contribute additional funds to the multilateral development system.
- Contributors should reverse the trend of growing shares of earmarked funding by increasing core funds across organisations.
- Contributors should use earmarked funding more prudently to support rather than undermine multilateral functions. Multi-donor pooled funds are a viable alternative.
- Multilaterals should invest in transparent institutional mechanisms that provide checks for resource mobilisation.

Introduction

Multilateral organisations were founded based on the idea that member states would collectively decide which actions to take and collectively provide the necessary means through membership fees or voluntary core contributions. Such core funds come without restrictions and can be allocated in line with the decisions of intergovernmental governing bodies, usually providing some leeway to multilaterals. For multilateral development organisations, core funds are usually allocated in line with their thematic priorities (poverty alleviation, reproductive rights, governance etc.) and a geographic focus on less developed countries.

The practice of earmarking contributions emerged in the early post-war years along with the invention of multilateral development cooperation, but it was only in the 1990s that earmarked funding started to grow massively, and at a faster pace than multilateral core funding. With a volume of US\$ 24 billion, in 2018 earmarked funding amounted to 35 per cent of total multilateral funding by OECD/DAC donors, which stood at US\$ 69 billion.

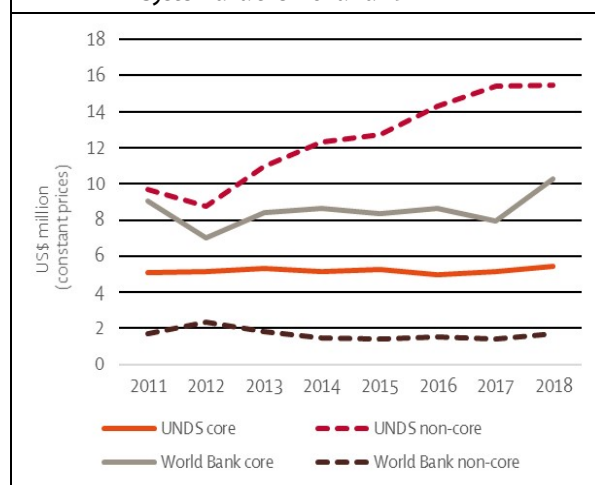
Earmarked funds come in various forms, which share three features: a) they are always voluntary both for donors and the organisation; b) donors specify a purpose; and c) multilateral governance bodies have less discretion over how the funds are used than over core resources.

Despite an overall trend towards increased earmarking across the multilateral system, organisations are affected to different degrees, both with regard to their share of overall earmarked funds and to their internal ratio of core and earmarked funding. The European Union receives a relatively small share (4 per cent) of the total of earmarked funds provided to multilateral development organisations by OECD/DAC donors, which is so far dwarfed by its core resources. Regional development banks receive a similar overall share, yet “trust funds” (as earmarked funds are referred to in the multilateral development banks) have grown in importance. The World Bank receives 14 per cent of overall earmarked funds, and trust funds have developed into a sizeable source of revenue. The United Nations development system (UNDS) (including 43 funds and programmes, specialised agencies and other units active in development and humanitarian activities) has been receiving the bulk of overall earmarked funding (72 per cent in 2018). At the same time, earmarked contributions now make up close to 80 per cent of overall UNDS resources, also because core funds have been stagnating (See Figure 1).

All multilateral development organisations have developed distinct approaches to managing earmarked funding. These approaches still allow for a degree of customisation, where details are subject to negotiations between individual contributors and fund managers. Despite formally calling for increased core funding and more streamlined forms of earmarking, organisations may still accommodate special requests to attract resources. The most common modality is that an organisation receives funds – often at the country level – for a specific programme, project or activity. In

addition to bilateral funding arrangements, there are also country-specific multi-donor arrangements with the aim of coordinating and pooling efforts at country level, specifically in the area of humanitarian affairs or in fragile states. Organisations have also created multi-donor trust funds for specific thematic priorities, which allow member states to strengthen an organisation’s work in one particular programmatic area. Such pools are especially useful for dealing with global public goods, a topic which the World Bank has embraced at a greater scale. In the UNDS, a more programmatic, country-based approach to global challenges prevails.

Figure 1: Funding to the United Nations Development System and the World Bank



Source: Authors' own analysis, based on OECD, 2020.

Drivers of earmarked funding

We can distinguish between drivers on the supply side (contributors) and on the demand side (organisations). For contributors, earmarked funding has been portrayed as a means to exert influence and control over the agenda of international organisations, bypassing multilateral decision-making structures. But there are other motives as well. Contributors also seek to reinforce their geographic and thematic bilateral priorities through multilateral organisations. Multilaterals may also be used in a complementary way, for example, in areas where donors themselves are lacking administrative or operational capacities, in countries where they are not physically represented or where they consider multilateral organisations to be best suited as implementing partners. Last but not least, domestic needs for more accountability, efficiency and effectiveness of development interventions are important drivers. Because earmarking involves additional accountability requirements and a closer involvement of donors, the argument goes, donors ensure the adequate use of their funds. Earmarking also provides governments with greater control over how their funds are spent and visibility with regard to local or domestic actors.

From a demand-side perspective, for multilateral organisations, earmarked funding provides a means to grow

the organisation. In a highly competitive environment with overlapping mandates and competences, funding ensures relevance, reputational gain and survival, but also the ability to work towards mandate implementation. In this way, earmarked funding may informally compensate for a shortage in core funding. This holds for organisations in their entirety, but also for particular offices, be it in the field or at headquarters, which often depend on earmarked funding.

From the perspective of the multilateral development system as a whole, earmarking has acquired aspects of a self-reinforcing practice. Earmarking has arguably led to a dilution and expansion of development organisations' mandates, which in turn has incentivised greater earmarking. When contributors use multilateral organisations as implementing partners, the latter might indeed embrace these roles, commercialising their operations and potentially compromising their multilateral mandates and functions in the interest of resource mobilisation. This can give rise to divisive issues, such as freeriding and preferential treatment for large donors, for example through waivers regarding due overheads and access to decision-makers in administrations. All of this puts a strain on member states' readiness to engage in collective action through multilateral organisations. It also lowers incentives for providing non-earmarked contributions at a large scale.

Consequences of earmarked funding

Earmarking arrangements may differ considerably with regard to their advantages and disadvantages for donors, multilateral organisations and recipients. They also have implications for the broader multilateral development system and the effectiveness of development interventions. There is a growing awareness that earmarking comes with trade-offs, both direct and systemic, which are not yet sufficiently well understood (Weinlich, Baumann, Lundsgaarde, & Wolff, 2020).

Earmarking, if applied prudently, can play an important role in supporting multilateral organisations. Arguably, the practice of earmarking pushes organisations towards greater results-orientation and accountability. While earmarking is often likened to a "bilateralisation" of multilateral organisations, it can also mean the "multilateralisation" of otherwise bilateral resources. This opens up the possibility of bolstering and expanding multilateral efforts. For instance, in the multilateral development banks, earmarked funds can strengthen lending projects through extra funding for analytical work and capacity-building. In the UNDS, pooled funds in which two or more donors bundle their resources can improve policy coordination for greater impact and help multiple UNDS entities work together for collective outcomes.

Earmarking is also a means to expand organisations' resource bases and engage in partnerships with contributors in order to work towards mandate implementation. Member states can thereby support new or innovative topics as well as

facilitate work in difficult country contexts. Earmarking allows contributors, on the basis of their partnerships with organisations, to fill gaps in multilateral agendas and support crucial issues, such as gender and governance, on which mandates are contested. Thus, earmarking can sustain international organisations in contexts and phases where member states collectively lack the political will to agree on common goals and agendas.

Notwithstanding these positive aspects, we observe a number of negative consequences of earmarking that undermine the multilateral assets of international organisations and their ability to provide strategic and transformative support for the implementation of the 2030 Agenda. Earmarked funding arrangements increase transaction costs and undermine multilateral administrations. The preparation, negotiation, implementation and reporting on earmarked funding arrangements is costly and labour intensive. This applies both to organisations and donor bureaucracies that might struggle to stay atop of managing and monitoring the manifold funding arrangements (Weinlich, Baumann, & Lundsgaarde, 2020). The number of donor reports can run into the thousands annually, and the associated workload binds resources and staff capacities needed for implementation work. In addition, unstable resource flows associated with earmarking lead organisations to increasingly rely on consultants and outsource part of their core business in the process, which undermines their ability to build and consolidate their expertise and thus legitimacy.

Other implications relate more fundamentally to the way multilaterals work, or should work, to bring their multilateral assets to bear on the implementation of the 2030 Agenda. Ideally, bilateral donors and multilateral organisations should support partners with coherent and strategic multi-year programmes that are based on the national political priorities. In practice, earmarking comes with a propensity for donor-driven programmes and interventions. While partner governments typically sign off on them, the implication is that they are not sufficiently involved to replicate, scale up or draw crucial lessons from such interventions, potentially reducing impact and sustainability. In addition, piecemeal earmarked support results in fragmented implementation efforts. Donors themselves have difficulties enforcing their own priorities in an environment of dispersed decision-making (e.g. across different ministries or between headquarters and the field level) and may respond with more stringent forms of earmarking.

Multilateral organisations are at their best when they support the implementation of the 2030 Agenda with well-coordinated, knowledge-based and cross-sectional interventions that aim at systemic change or address urgent needs in crisis contexts. Earmarking, however, comes with a propensity to tackle relatively narrow, isolated and easily measurable goals that can be achieved in a short time. It discourages longer-term interventions, risk-taking and attention to systemic change. Furthermore, fuelling

competition among organisations hinders the kind of cooperation needed for addressing complex development problems, most notably within the UNDS, where the presence of multiple (on average 18) agencies in a country provides the potential for delivering as one for greater impact. The 2030 Agenda calls for a holistic approach produced by organisations with different specialisations working better together.

Earmarking also undermines the multilateral assets that lie in organisations' normative and convening functions. Multilateral organisations are vested with legitimacy and authority, which gives rise to a certain degree of independence both from member states and societal stakeholders. Thus, they have a unique role as neutral and trusted partners in bringing together stakeholders from different levels of government and across the political and societal spectrum in order to facilitate a public goods orientation within countries (but also globally). These qualities enable staff to take a stand on normative issues. In practice, the high proportion of earmarked funding means that agencies are deeply immersed in project work and lack the financial resources and staff capacity, as well as the independence, required to act as agents for change.

Conclusion

Fuelled by power shifts in the international system, as well as nationalism and populism, there is a crisis of multilateral cooperation. This includes a fight over which norms and values should guide such cooperation in the future. Earmarked funding is an à la carte approach to multilateral development

cooperation. As such, it can be valuable and can strengthen crucial functions. Yet at the current scale, earmarked funding is seriously affecting what multilaterals can deliver; it risks undermining multilateral assets and destroying multilaterals as a counterweight to particular national interests. These repercussions seem at odds with the strong multilateral system needed in an age of global interdependencies and pressing global governance challenges.

Member states and multilaterals need to stop the self-reinforcing practice where earmarked funding begets more earmarked funding. The following steps would be helpful:

- A larger number of contributors, also beyond the OECD/DAC, must contribute additional funds to the multilateral development system for its support for the universal 2030 Agenda.
- Contributors should reverse the trend of growing shares of earmarked funding by increasing core funds across organisations, especially in light of the foreseeable demands created by the COVID-19 pandemic.
- Contributors should use earmarked funding more prudently to support rather than undermine multilateral functions. Multi-donor pooled funds are a viable alternative. The UN's 2019 Funding Compact provides a framework in that regard, as does the World Bank's Umbrella 2.0.
- Multilaterals must invest in transparent institutional mechanisms that provide checks for resource mobilisation.

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