

**Comment on: Arne Bigsten,  
“Donor coordination and the uses of aid”**

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## **Comment on: Arne Bigsten, “Donor coordination and the uses of aid”**

This is a compact, comprehensive review and a valuable critique of existing theory and evidence on the effects donor coordination on aid effectiveness. It is very timely; several European countries have predicted large increases in ODA over the next few years, without specifying exactly if or how such expenditures may be coordinated, and the US is in the midst of historically large increases in bilateral aid to certain sectors and countries. We need lessons on how much coordination will matter in these endeavors.

But as Prof. Bigsten’s draft reveals, we do not know very much. And the little evidence we have is open to other interpretations than this draft gives. The draft reviews several studies of the transactions cost effects and incentive effects of poor donor coordination, and concludes that the costs constitute a problem that “needs to be addressed” with policy. It lists several ways that policy could or should do so. A different reading of the same studies suggests the opposite: that what we know about transactions cost effects is that they are a comparatively minor determinant of aid effectiveness undeserving of priority, and that we have little idea if cures for the incentive effects would be worse than the disease.

Only the availability of much more evidence could lead us to the kind of strong and practical conclusions towards which this draft leans. The draft thus evokes an empirical research agenda that is tractable, relevant and ripe. It is thereby provocative in the best way.

### Transactions costs

The draft methodically reviews the literature attempting to measure the transactions costs of aid, and concludes that these costs are “substantial” (p. 16). This conclusion seems unjustified. This section mentions one study of Vietnam in which the transactions costs of aid could not be measured because, presumably without an intentional play on words, the transactions costs of measuring them were too high. Next is a piece reflecting on recipient administrators’ time savings from coordination, but “there have not been any substantive analyses of these” (p. 14). Next the draft mentions cross-country attempts to assess donor coordination but these have “not provided solid empirical estimates of the benefits”. The draft goes on to mention an assessment of “one of the most ambitious attempts to coordinate donors”, in Tanzania, but “there is no clear evidence yet that the overall sum of transaction costs of aid in Tanzania has fallen” (p. 15).

In short, *all* of the studies of transactions costs reviewed in the draft are described as failing to provide any clear evidence of the magnitude of these costs or the benefits of coordination. What, then, are the grounds for concluding at the end of this section that transactions costs are “substantial”, or that they “clearly” (p. 20) are large enough to merit large-scale policy intervention? It is quite plausible that the reason they are so difficult to reliably measure is precisely that they are small relative to other determinants of aid effectiveness, and thus do not deserve priority policy action.

In the same breath the draft recommends more empirical work to try to measure transactions costs, and that is certainly needed. One way forward would be to assess the effects of project proliferation on outcomes of interest, across countries and over time. That is, interesting future work would build on that of Knack and Rahman (2004), who attempt to measure the effect of donor-level fragmentation on governance, and would extend this to assess the relationship between project-level proliferation data (Roodman 2005a, 2005b) and various desirable human development outcomes.

Here we can dip just a toe into those empirical waters. Figure 1 shows histograms of the extent of donor-level fragmentation and project-level proliferation in the OECD DAC database. The upper panel shows, for example, that five aid recipient countries received ODA disbursements from an average of 11 donor countries per year between 1995 and 2003. The lower histogram goes to the project level, showing for example that four recipient countries received around 300 average project disbursements per year between 1995 and 2003. There is obviously a great deal of variation; some countries have very few projects from a handful of donors; some host a score of donors and hundreds of projects. How can we get a general impression of the magnitude of the costs thereby imposed on the latter group?

We want to isolate those countries that have hosted an unusually large number of donors or projects. Certainly we would expect countries that received more aid to host more donors and projects, as well as countries with larger economies. Furthermore, we might expect countries with stronger institutions of governance to attract different numbers of donors or projects than those with poor governance.

Figure 2 shows a histogram of the residuals from a cross-section regression of the number of donors on three independent variables: total aid, GDP, and the well-known ratings of overall governance quality by Kaufmann, Kraay, and Mastruzzi (2004). The vertical axis shows the number of recipients with each residual within the range shown. Countries further to the right host more donors than other recipients with equivalent aid flows, economic activity, and governance quality.

Do we find notable aid *failures* towards the right of the graph? It is precisely the opposite. To the right we find many of the poor countries considered to be those most likely to use aid effectively by several observers, including the UN's Millennium Project and the US Millennium Challenge Corporation: Uganda, Mozambique, Kenya, Rwanda, Senegal, Botswana, and Ghana. These are the success stories of aid in the opening years of the 21<sup>st</sup> century, not the basketcases. Also present are Chile, Costa Rica, and others where aid has clearly been effective.

Figure 3 carries out the same exercise for project proliferation, reporting the residuals from regressing the average number of annual project disbursements on the same three variables. The lower panel shows a detail of the upper panel for clarity of presentation. Again, the countries that have received their aid chopped into an extraordinarily large number of projects include Ethiopia, Senegal, Mozambique, Uganda, Kenya, Botswana,

and Poland. Far from being aid disasters, these include precisely the countries donors frequently cite as examples of ideal leaders of the coming aid “scale up”. Where is the large-scale institutional degradation observed by Knack and Rahman?

Could reverse causation be at work here? Certainly; a large number of donors have a large number of projects in Uganda and Mozambique *because* they perceive aid to work well there. That is, the above uses no careful identification strategy and is merely suggestive. But we are controlling for governance quality, which addresses some of that concern, since this is part of what creates a ‘donor darling’. And at the very least we can see that a major lack of coordination at the international or country level did not produce transactions costs that were large enough to change overall aid effectiveness in those countries. The primary determinants of aid effectiveness lie elsewhere, and it is those primary causes that will fix the fate of the great aid scale-up in coming years. If true, this would undermine other strong but poorly substantiated conclusions in the draft, like: “Coordination of donors’ goals ... would ... increase the overall development impact of aid” (p. 5) to a meaningful degree that would reward the attention we are paying to the issue. Neither the extremely preliminary evidence here nor the evidence cited in Prof. Bigsten’s review begins to suggest that such benefits are in any way large.

#### Incentive effects

The draft mentions a few times, but briefly and with little discussion, the single most important incentive issue. The elephant in the room comprises the incentives that *cause* donors to give their assistance in uncoordinated fashion, bilaterally and as projects. This literature cannot advance until we move beyond considering the *effects* of fragmentation to its *causes*.

As Bill Easterly (2002) points out, every generation exhorts donors anew to coordinate. When United States President Harry Truman (1949) proposed foreign aid in its modern form, he urged donors to “pool their ... resources” for a “cooperative enterprise in which all nations work together through the United Nations ... wherever practicable.” The resounding Pearson (1969, 228-9) Commission report warned of the “urgent need for early action” to standardize donors’ planning, programs, and evaluation for each recipient, as well as a large increase in the share of aid passing through multilaterals. The World Bank’s (1981, 130) Berg Report noted most of the main costs of aid fragmentation pointed out in Prof. Bigsten’s draft, including that donors “compete for scarce skills by bidding up salaries” and that the “multiplicity of donors, each operating independently, puts an especially heavy burden on small countries with limited administrative capacities.” Now the Blair (2005) Commission report speaks throughout of the need for tools of coordination like “joint needs assessments” to improve the impact of aid in Africa.

Even if we had solid evidence that the costs of proliferation and fragmentation were sufficiently important determinants of aid effectiveness to warrant priority policy action—and we do not—the marginal return to additional exhortation to coordinate clearly reached zero decades ago. Donors are not willing to coordinate beyond a certain

point; we can see this by recognizing that all coordination plans constitute some form of multilateral action, and donors' demand for multilateral aid channels is limited. IDA has been available as a harmonized aid channel for almost 40 years, and offers its collected donors unified planning through a single Country Assistance Strategy as well as common criteria for ex ante selectivity and ex post evaluation. It is currently moving toward outcome-based selectivity, gives *de facto* grants to many of its members (via high concessionality and debt forgiveness), and may soon give *de jure* grants as well.

But donors avail themselves of this channel in small doses. Early in aid's history the limiting factor may have been the absence of policy instruments for international coordination; after IDA was created, the worldwide share of aid passing through multilaterals shot from about a sixth to about a third. But as Prof. Bigsten's draft notes without much comment, this share has stayed at about one third ever since (Figure 4). While some donors have mildly increased the multilateral share of their flows, due primarily to EU integration, others have correspondingly decreased it (Table 1). The demand for country-level coordination, too, is shrinking: Prof. Bigsten's table points out that program aid has steadily declined in importance relative to project aid. We cannot hope to make progress without evidence on *why* donors do not want more coordination.

The draft certainly demonstrates awareness of political economic forces driving donors' reluctance to coordinate, noting inherent difficulties in aggregating their preferences and their need to "report home" about successful projects. These are treated as mere obstacles to greater coordination, the latter being presumed good. But no instrument of public finance is optimal if it is only optimal on the expenditure side, ignoring the revenue side. Do we have any useful evidence? And what would it mean for policy?

Figure 5 sketches what useful evidence might look like. The horizontal axis shows total government revenue as a fraction of GDP, and the vertical axis shows the fraction of total aid that is given through multilaterals. The relative sizes of the bubbles reflect relative total aid in dollars. Especially for the most important donors, there is suggestive evidence that countries with voters less willing to be taxed give more of their aid bilaterally. It is notable that Denmark, the Netherlands, Norway, and Sweden appear to give somewhat less of their aid multilaterally at comparable levels of revenue collection, and that these are also precisely the four donors with the highest level of aid as a fraction of GDP. Perhaps the need to "plant the flag" in order to convince voters to support aid is even greater, all else equal, when a donor devotes a particularly large fraction of revenue to aid.

The above is solely suggestive and does not constitute definitive evidence in any way. But there is ample reason to believe that donors' preference for uncoordinated aid may be revenue-optimal and may always have been. Decades ago, Rosentein-Rodan's (1968) ideal solution to coordination problems was a single all-embracing international aid agency. But he recognized, "Even under the present largely bilateral arrangement ... there is great difficulty in raising the volume of aid adequately. If all aid were to be channeled internationally, it seems that only a fraction of the present volume of aid (say one half or up to optimistically two thirds) might be obtained."

This is extremely important. Even if we believe that the costs of low coordination are very large, we cannot hope to suggest good policies without understanding the reasons behind low demand for coordination. Any further policy recommendations on coordination without such analysis will be added to a half-century tradition of ineffective exhortation, and soon forgotten. But even beyond this, a better understanding of the political economy of donors' taxation may lead us to a different vision of optimal public finance in this case, one that incorporates the revenue side. The result might be a vision of fragmentation and proliferation as an equilibrium that balances the marginal costs of raising or lowering coordination.

Put differently, donor coordination does have *costs*, and they may be large. "International" donor coordination means, speaking schematically, that the French government must be willing to cede control of some of its aid money to the "lead donor" in a given case—Sweden, say, or the World Bank. To the extent that the goals of the French government differ from those of Sweden or the Bank, this will make it harder to convince French taxpayers to support the effort. "Country level" donor coordination, in turn, means that the French government must be willing to cede control of some of its aid to, say, the government of Tanzania. To the extent that France's goals differ from the Tanzanian government's, or that the Tanzanian government faces capacity constraints in utilizing aid for poverty reduction, this coordination too can undermine the domestic French constituency for aid. Until we know the magnitude of these effects, sweeping policy measures are premature.

### Policy

A vision of policy optimality that moved beyond the expenditure side to the revenue side—addressing the political economy of *why* we have so little coordination—might suggest very different policies than one that does not. First let us look at several policy recommendations that emerge when we make no serious analysis of donors' incentives.

- Rosenstein-Rodan (1968) proposed "bilateral aid within a multilateral framework", that is, international agreements on common conditions for and evaluation of aid flows based on technical criteria. The OECD's Development Assistance Committee may one day be, he wrote, a good forum for negotiation of such agreements—but at the time it was "a feeble, unsatisfactory, insufficient beginning", because of "member governments' reluctance to commit themselves to a delegation of aid decisions." There is schizophrenia here. In the same article, as mentioned above, he notes that ceding aid sovereignty would undermine domestic constituencies for aid and produce a collapse in budget allocations to aid. But this does not stop him from later implicitly ascribing their "reluctance" to cede authority to a kind of ignoble, autarkic petulance.

- In a little-known move, the administration of Republican US President Richard Nixon recommended in 1970 that *all* American aid go through multilaterals.<sup>2</sup> Whether this was a sophisticated strategy to reduce foreign aid or genuinely motivated by concerns to increase its effectiveness is of little relevance here and may be unknowable. At any rate it did not happen, being clearly unpalatable to both the US Congress and to other donors (who, according to the plan, would also have to shift their aid to fully multilateral).
- When the Berg Report (World Bank 1981, 127) noted the heavy burden of project proliferation on recipient administrative infrastructure, it proposed an answer: an exciting new form of simplified program aid called Structural Adjustment Lending. In hindsight, many economists have had difficulty coming to a favorable assessment of this solution—to put it lightly (e.g. Easterly 2005). Prof. Bigsten’s draft notes multiple studies extremely skeptical of the efficacy of structural adjustment conditionality (p. 9), but then asserts without evidence that coordinated conditionality was effective in changing recipients’ policies. If this was so, donors appear not to have noticed; donor fragmentation has remained stable and project proliferation has greatly increased since the structural adjustment era. Prof. Bigsten’s draft also oddly claims that the Marshall Plan was “successful in influencing institutions” in its recipients substantially because they “only had to deal with one donor” (p. 18). French political institutions were already extremely strong; were they get meaningfully stronger relative to the counterfactual simply because there were fewer forms to fill out in the late 1940s?
- Prof. Bigsten notes (p. 9) that Sector Wide Approaches (SWAPs) have attempted since the early 1980s to pool donor resources in certain limited spheres of action, but these have been sufficiently difficult, costly, and slow to negotiate that it is unclear if there is any efficiency gain.

A similar vision of policy optimality, looking only at the donors’ expenditure side, informs the policy section of Prof. Bigsten’s draft. The section takes the desirability and priority of coordination as given and explores its complexities, but does not explore the possible costs of policies to increase coordination or why so many different coordination schemes attempted in the past have received so little commitment from donors. This section is appropriately circumspect and for the most part wisely avoids strong policy recommendations from weak evidence. But it is emphatic that something must be done since “[c]learly the lack of donor coordination imposes greater transaction costs and creates negative incentives” (p. 20), despite citing several studies completely inconclusive about the magnitude of the transactions costs and despite noting that there is “even less” evidence about incentive costs (p. 16).

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<sup>2</sup> On August 10, 1970, the administration sent the following confidential memo to several cabinet heads and all major US aid agencies directors: “The United States should seek to channel all of its development assistance through multilateral institutions as soon as practicable, in light of the capabilities of the institutions and without raising the US share in them.” National Archives RD59, S/S files, Lot 83 D 305, National Security Decision Memorandum 76 (Item 136 in State Dept. archives).

The fact is that we *do not know* whether or not the costs of some of the policies discussed in this section exceed the benefits. Yes, poor coordination “makes it easier for recipient governments to play off donors against each other to achieve the aid allocation they desire” (p. 19), but is this bad or good? Donors are loathe to see a dollar of aid spent on the military, for example, but many developing countries face real and dire security concerns. Yes, the lack of coordination “increases uncertainty about government policies, which tends to have a negative effect on investment” (p. 20), but sustained and predictable donor support for certain regimes has *also* depressed investment: by sustaining economically ineffective leaders in Liberia, Kenya, Tanzania, former Zaire, and other countries for far too long. Investment may have benefited from *greater* aid uncertainty in those countries, that is, from more willingness by donors to quickly turn off the aid tap. What would be the general equilibrium effects of the “common pool” proposal (p. 20), in which “[a]t no time is a particular part of the program identified with a particular donor”? Would this undermine donors’ domestic constituencies for aid? We do not know. The draft also floats the recommendation of the Blair Commission that bilateral donors coordinate more with the World Bank in Africa—seeming to ignore the fact that the *purpose* of giving aid bilaterally rather than through IDA is *precisely* so that donors do not have to coordinate with IDA. If donors wanted to coordinate with IDA there would be no better way to do so than to give their aid to Africa *through* IDA. Perhaps they face political constraints that make this impossible.

The one unqualified, unequivocal normative statement in the policy section is that “[d]onors should avoid poaching [of] skilled labor” (p.19). The draft proposes common agreements among donors on “salary and benefit levels” for their local collaborators to avoid bidding up their compensation. This raises eyebrows since, throughout the draft, public sector administrative capacity in recipient countries is cited as essential to effective country-level donor coordination. Collusion by donors into a labor oligopsony to keep salaries artificially low in the public sector is likely to have precisely the opposite effect, eliminating one more incentive for skilled citizens of the recipient to join the public sector or even remain in their country at all.

Certainly there exist policy recommendations compatible with a different vision of aid coordination optimality, though none of these would be recommendable until research—primarily empirical—gives us a better understanding of their effects. First, donors could easily decrease the internal incentives faced by their bureaucrats to “move money” at all costs—decreasing the number of projects and thus the administrative burden on recipients without any coordination among donors. Donors could focus much more on training and hiring the administrative capacity they need—making the sector more attractive to talented locals (the opposite effect of colluding to “harmonize” local counterparts’ compensation). Both of these are in the interest of individual donors acting alone.

Furthermore, donors could structure aid disbursements to a vastly greater degree around human development outcomes. Faced with such incentives, as Easterly (2002) has proposed, what some disparage as “incoherence” would yield the *benefits* of competition. Various bold experiments are afoot to try matching disbursements more closely to

development outcomes, such as the Global Partnership for Output-Based Aid, a trust-fund supported initiative at the World Bank, and the novel evaluation strategy of the Global Fund to Fight AIDS, Tuberculosis, and Malaria. Donors and the poor could strictly benefit from revamping aid systems along these lines, without an ounce of coordination. But again, we do not know enough yet about how to do this. The assumption behind much of the donor coordination literature seems to be that we know exactly what to do to transform Africa from without, if we could only find a way to get along with each other and work together. But we *not* know exactly what to do, and we also understand very poorly the causes and consequences of increased coordination. Bold experiments and rigorous evaluation are essential. These should be prioritized over vast scale-ups combined with (yet more) moral exhortation toward coordination.

Are radical changes wishful thinking? Eliot Berg (2002), who recommended so many changes to the aid system in 1981, concluded over two decades later that “little of the contemporary aid reform debate shows adequate appreciation of the depth of the crisis in the development assistance system, and the consequent need for its radical renovation.” What will we still be waiting for these changes two decades from now?

### Research agenda

A not at all exhaustive list of specific areas for further study:

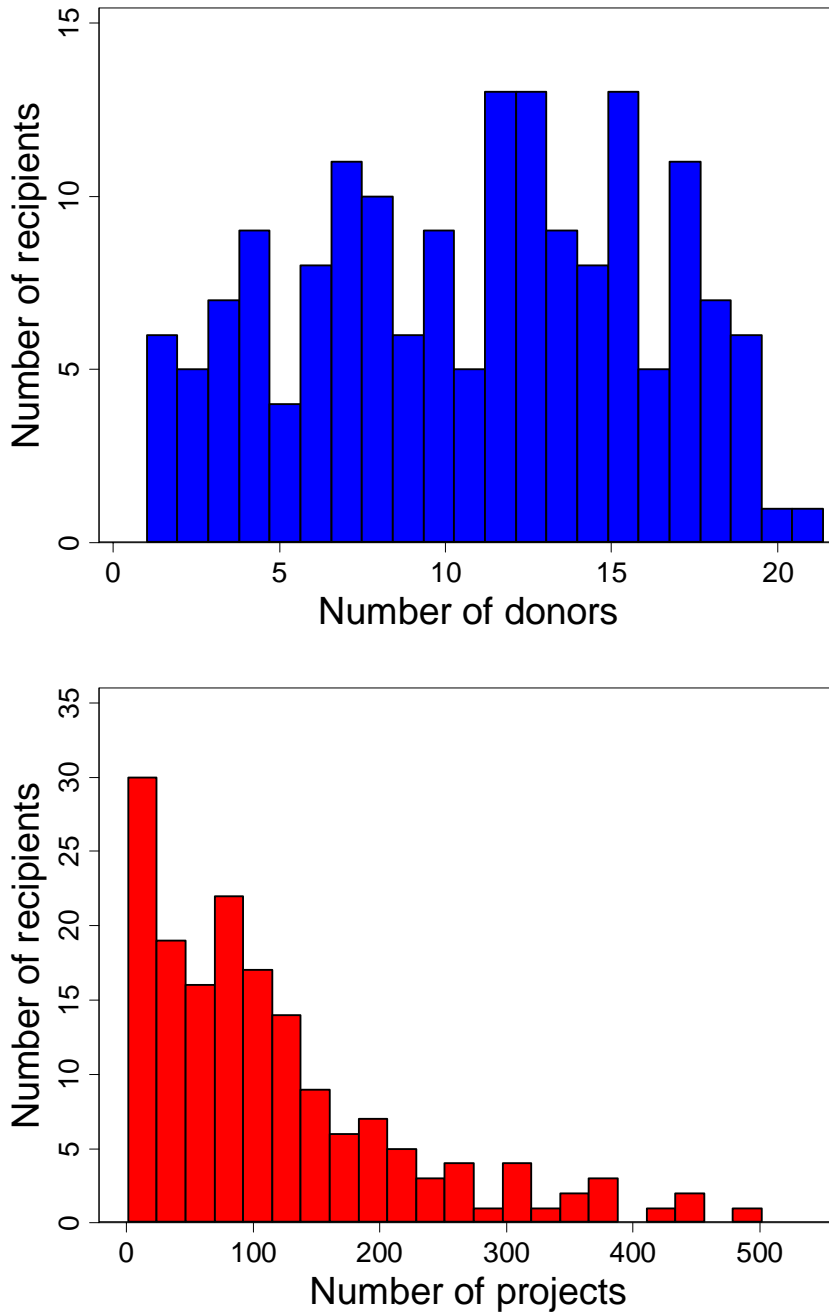
- Theoretical models of donor fragmentation and project proliferation, such as the excellent work of Roodman (2005a, 2005b) and Torsvik (2005), must mature to include donors’ domestic political economy rather than simply the games they play against each other.
- Cross-country identification strategies: Extending, as described above, the donor-level work of Knack and Rahman to project level proliferation, macro outcomes besides governance, and perhaps even project-level outcomes such as Economic Rate of Return. Problems will include identifying exogenous variance in proliferation and, if this literature is to identify the channels of effect as well as the magnitude, *measuring* the scarce input provided by recipients (e.g. quantifying ‘administrative capacity’ or ‘recurring costs’).
- Natural experiment identification strategies: Can we explore cases of strictly exogenous increases or decreases in fragmentation or proliferation? Around 1991, several countries of Central Europe as well as Vietnam and Cuba went from having one donor to having several. At other times, South Africa, Cuba, Burma and others experienced politically-motivated and sudden declines in the number of donors with which they worked. Has the creation of new internal political divisions, such as the recent creation of new states in India, substantially raised the number of projects? What can we learn from past experiments in coordinated conditionality like Structural Adjustment Lending?

- What can data the large store of data on IDA replenishment negotiations, or parliamentary debates, or poll data teach us about how donors' domestic political constraints shape their willingness to cooperate?

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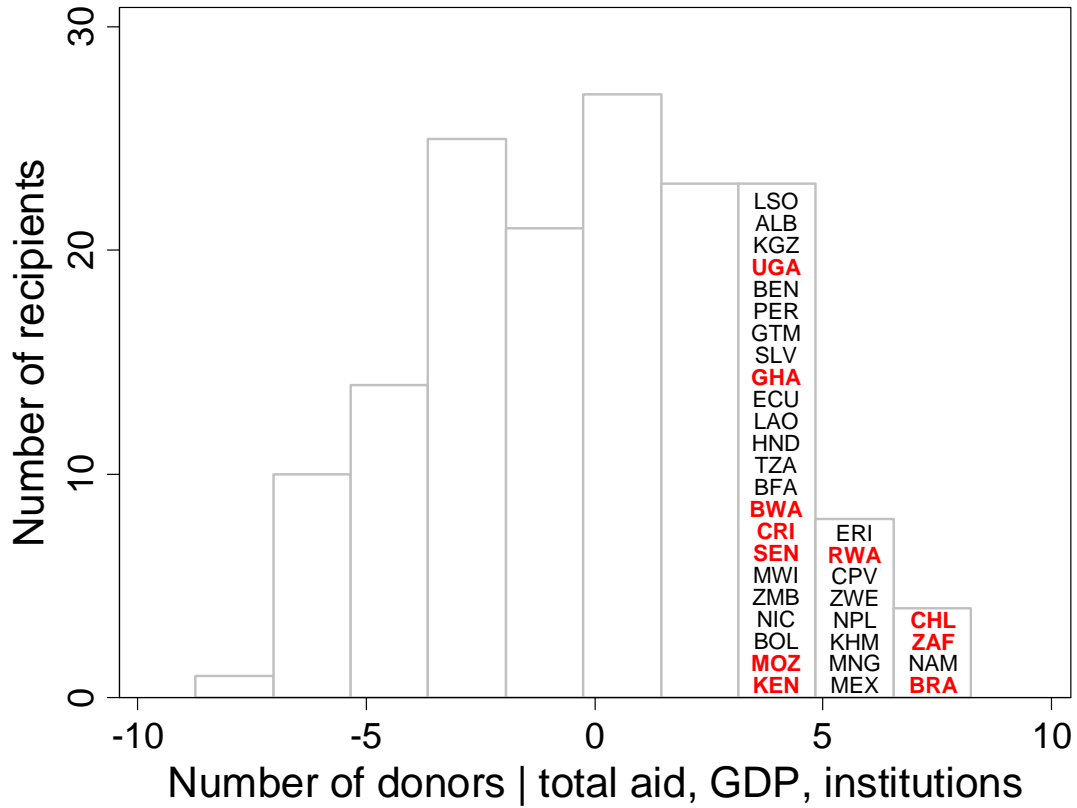
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**Figure 1.** Histograms showing (top) number of ODA recipient countries receiving ODA disbursements from each number of donor countries along the horizontal axis, average 1995-2003, and (bottom) number of ODA recipient countries receiving each number of annual project disbursements along the horizontal axis, average 1995-2003.



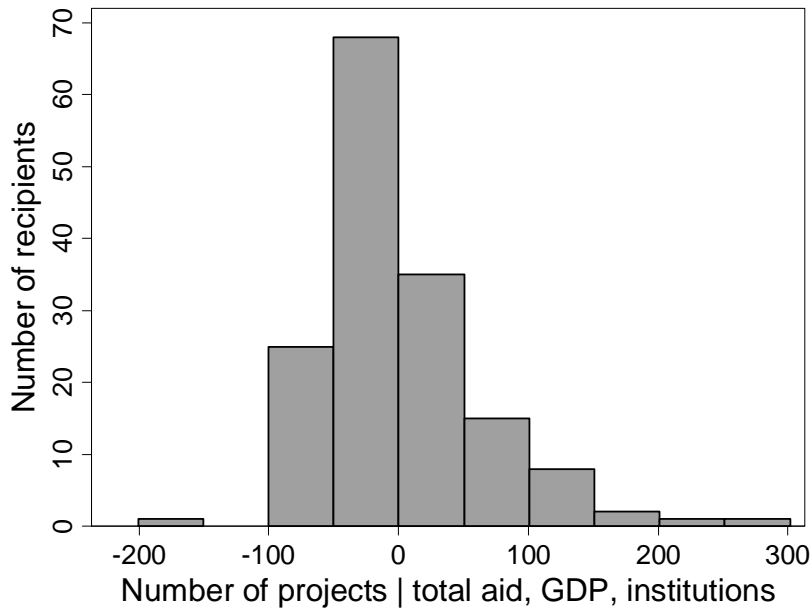
Source: Roodman (2005b) and OECD DAC database.

**Figure 2.** Are recipients with the most donor fragmentation—controlling for aid levels, economy size, and institutional quality—aid failures?

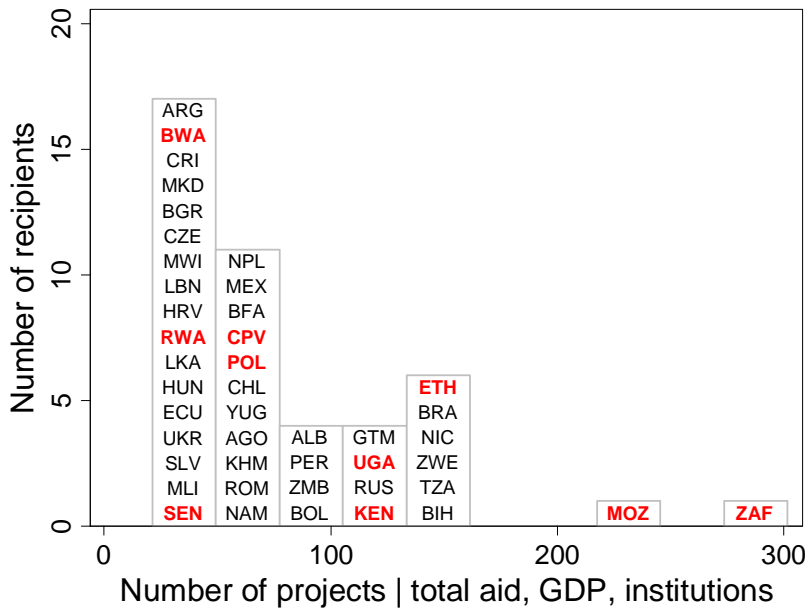


Source: Roodman (2005b) and OECD DAC database. Horizontal axis shows the residual after cross-section regression of the average number of donors disbursing ODA per year to each recipient on 1) total aid, in dollars during the period, 2) GDP at exchange rates, and 3) the overall governance quality indicator of Kaufmann, Kraay, and Mastruzzi. All variables averaged over 1995-2003.

**Figure 3.** Are recipients with the most project proliferation—controlling for aid levels, economy size, and institutional quality—aid failures?



*Detail of the above figure, showing recipient countries with residual > 20:*



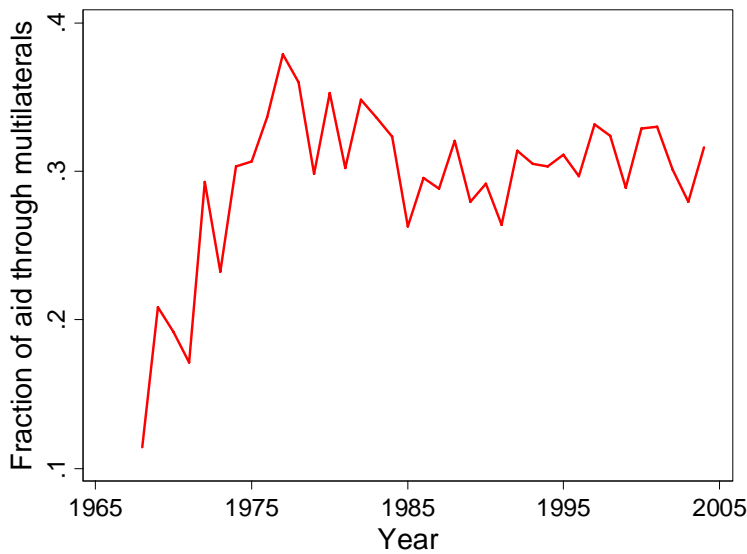
Source: Roodman (2005b) and OECD DAC database. Horizontal axis shows the residual after cross-section regression of the average number of ODA project disbursements per year to each recipient on 1) total aid, in dollars during the period, 2) GDP at exchange rates, and 3) the overall governance quality indicator of Kaufmann, Kraay, and Mastruzzi. All variables averaged over 1995-2003.

Table 1: Fraction of total ODA given through multilaterals

Donor	1974	1984	1994	2004
Australia	0.099	0.217	0.245	0.185
Austria	0.665	0.244	0.370	0.480
Belgium	0.235	0.411	0.401	0.383
Canada	0.306	0.361	0.368	0.234
Denmark	0.445	0.504	0.445	0.410
Finland	0.609	0.393	0.264	0.448
France	0.194	0.204	0.219	0.343
Germany	0.292	0.329	0.392	0.493
Greece				0.346
Ireland	0.829	0.577	0.480	0.326
Italy	0.999	0.448	0.322	0.714
Japan	0.218	0.438	0.278	0.336
Luxembourg				0.274
Netherlands	0.306	0.307	0.324	0.365
New Zealand	0.248	0.200	0.226	0.250
Norway	0.445	0.437	0.272	0.301
Portugal			0.307	0.154
Spain			0.345	0.425
Sweden	0.418	0.290	0.245	0.237
Switzerland	0.340	0.235	0.263	0.232
United Kingdom	0.367	0.452	0.449	0.323
United States	0.308	0.259	0.266	0.175

Source: OECD DAC database. Multilaterals are: Af.DB, Afr. Solidarity Fund, African Dev. Fund, Andean Dev. Corp., As. D B, As. D B Special Funds, CABEI, Caribbean Dev. Bank, EC, EDF, EFTA Ind.Fund Portugal, EIB, FUNDWI, IBRD, IDA, IDB, IDB Special Oper. Fund, IFAD, IFC, IMF, IMF Int. Subsidy Acct., IMF Trust Fund, MIGA, Other Multilateral (Part I), Other Regional Banks, Other UN, UNDP, UNFPA, UNHCR, UNICEF, UNRWA, WADB, WFP.

**Figure 4.** Fraction of ODA from DAC member countries given to multilateral organizations



**Figure 5.** There is some evidence that donors raising less tax revenue give more of their aid bilaterally

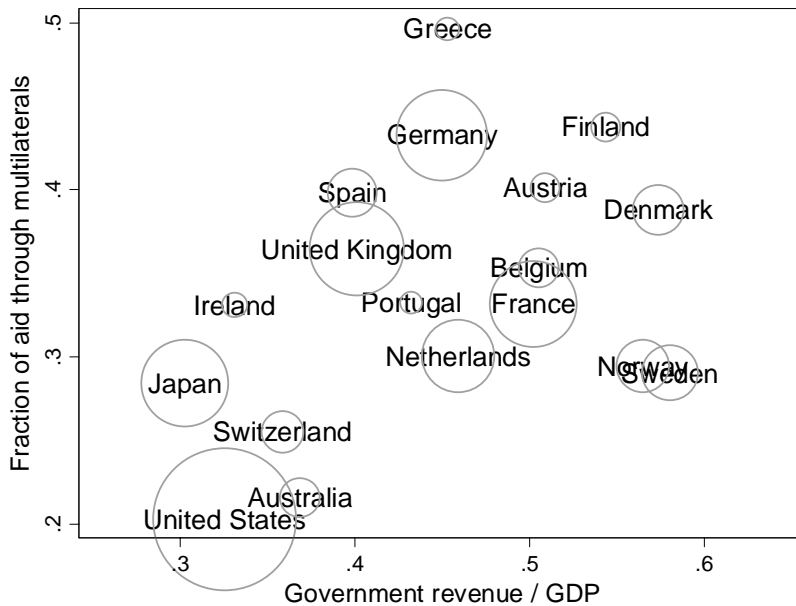


Figure 4: Areas of circles represent relative total ODA in US\$ in 2003. Gov. revenue/GDP is in 2002, from OECD national accounts. Figures 4 and 5: Fraction of aid through multilaterals is average 2000-2004, from OECD DAC database. Multilaterals are: Af.DB, Afr. Solidarity Fund, African Dev. Fund, Andean Dev. Corp., As. D B, As. D B Special Funds, CABEL, Caribbean Dev. Bank, EC, EDF, EFTA Ind.Fund Portugal, EIB, FUNDWI, IBRD, IDA, IDB, IDB Special Oper. Fund, IFAD, IFC, IMF, IMF Int. Subsidy Acct., IMF Trust Fund, MIGA, Other Multilateral (Part I), Other Regional Banks, Other UN, UNDP, UNFPA, UNHCR, UNICEF, UNRWA, WADB, WFP. One outlier, Italy, has been suppressed for presentation.