

Conflicts of Objectives and Task Allocation in Aid Agencies: general issues and applications to the European Union

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Abstract

This chapter reviews and extends the literature on incentives in large organisations, applying it to the work of aid agencies in general and the European Commission's own foreign aid programme in particular. It identifies the main predicament of such organisations as a lack of direct answerability to beneficiaries, accountability to a multiplicity of donors, and a major difficulty in monitoring the quality with which certain important tasks are performed. The result is an excessive focus upon input-related tasks (budgets, personnel) and insufficient attention to the quality of the aid projects undertaken. The question arises to what extent these are inevitable given the constraints on an aid agency, and to what extent they can be alleviated by intelligent organisational design. The chapter therefore reviews the literature on principal-agent models, particularly those with multiple principals and multiple tasks performed by each agent. It then presents a two-period model of the allocation of multiple tasks within a bureaucratic organization. It shows that the incentives for bundling and separation of tasks within such an organization depend on the relative ease of monitoring of the two tasks, as well as on the extent of correlation between the talents they require. It demonstrates that organizations may rationally place "too much" emphasis on routine tasks, provided these reveal information about talents that may be valuable in non-routine tasks, and in spite of the fact that the incentives to perform the non-routine tasks well will thereby be blunted. Applications to the work of the European Commission, and policy implications, are extensively discussed.

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1. Introduction: the problem

Aid agencies differ from other organisations in the public and private sectors of society in a number of important ways, but most strikingly in that the people for whose benefit they are supposed to work are not the same as those from whom their revenues are obtained. Some people (taxpayers or private donors as the case may be) pay money directly or indirectly to the agency so that other people may benefit. This simple fact may seem unremarkable, but in reality it creates a strikingly difficult set of problems in institutional design.

Why should this be so? Other types of organisation, both public and private, carry out activities for the supposed benefit of those who pay them to do so. If the supposed beneficiaries are not happy with the benefits they receive they can protest – either by withdrawing their custom (if the organisation operates in a market), or by voting against the political authorities (if the organisation is controlled by a political process). In order to find out whether the benefits received are adequate given the costs, the beneficiaries need only consult themselves and their own preferences. Does this product yield good value for money? Are these public services worth the taxes we pay? Such interrogations of oneself are the stuff of daily life in all free societies.

Aid agencies are quite different. It sometimes happens that the sponsors - taxpayers or donors or both - judge an aid agency purely by its public pronouncements (as though the principal task of the agency were to deliver public pronouncements rather than to deliver aid). But more often they are concerned to know to what extent the agency is doing the things that the supposed beneficiaries need. However, this is extremely difficult to evaluate, since there is frequently no obvious mechanism for transmitting the beneficiaries' view of the process to the sponsors. Instead the sponsors must rely on various indicators of performance, some of which are easier to measure than others, and the relative weighting of which is extremely hard to assess and will typically differ from one sponsor to another. In other words, it is intrinsic part of the predicament of aid

agencies that they are subject to multiple conflicting criteria of evaluation. They perform multiple tasks, and they are answerable to multiple sponsors with differing evaluations of those tasks.

Note that the argument here is quite subtle. There is nothing unusual about the multiplicity of tasks: except in a trivial sense of the word “task” any person in any organisation performs multiple tasks. But in many organisations these tasks result in an outcome which is evaluated by the person directly affected, who is therefore in the best position to judge the contribution of the different tasks to the overall result. In an aid agency, by contrast, the overall evaluation must be performed by someone who has only the outcomes of the different tasks to go on and who has only limited capacities to observe them. There is no clearly defined trade-off between various tasks and the goals to be accomplished – in contrast to private companies where profit is the single goal and the trade-off with various tasks is more easily measurable.

Is it surprising, then, that aid agencies frequently behave in ways that display an over-reliance on formal rules as against the exercise of sound judgement, a tendency to worry too much about meeting quantitative targets and not enough about the quality of the grants or loans they make? Is it any wonder that they pay too much attention to the performance of tasks that are easy to monitor, like the drunkard looking for his lost keys under a lamp-post because "that's where the light is"? Is it remarkable that they pay more attention to the inputs to the aid process than to the outputs? And if the answer to some of these questions is "yes", is that inevitable given the intrinsic nature of aid agencies themselves, or is it something that intelligent organisational design could reasonably hope to avoid? This chapter seeks to shed light on some of these important questions.

The argument of the chapter proceeds through a number of steps. First, many aid agencies (though not all²) are themselves public administrations, and suffer in consequence from problems characteristic of public administrations everywhere. These

² The rider is important. Aid agencies suffer from the problems identified here even when they are not public administrations, although the problems of public administrations in many circumstances aggravate those that are particular to aid agencies.

include multiple objectives, the difficulty of measuring results, and consequently weak incentives for staff, including relatively fixed salaries and a dependence on internal promotion procedures that invite information manipulation to advance careers. Some valuable insights into these phenomena have been yielded by recent developments in principal-agent theory, which deals with the incentive issues that arise when there is a serious divergence of interest between those who perform tasks (*agents*) and those on whose behalf the tasks are performed (*principals*). The first task of the chapter is therefore to review some of the general insights of these theories.

Next, we consider the more particular problems of the European Union as an aid donor. These arise for two main reasons:

- **First**, the European Commission (EC: the EU's administrative body) is not exactly like any other public administration. It is answerable not to a single principal but to fifteen different national governments, with theoretical if not *de facto* parity of status. This leads to potential conflicts of priorities that exceed in degree those of other public administrations. Even the well-known conflicts between executive and legislature in countries such as the United States and (to a lesser extent) France do not involve the administration in the need to respond to pressures from quite so many different directions. Furthermore, *none* of the pressures come directly from the aid beneficiaries themselves, who have no feedback mechanism for influencing the behaviour of the donor except through the circuitous route of influencing the donor's own principals. Since the donor's principals care directly about the inputs into the aid process (contracts for consultants and for the supply of materials), but only indirectly about outputs (effects in the beneficiary countries), the various biases characteristic of public administrations will almost inevitably be more striking in the case of the EC than in public administrations of the more familiar kind.
- **Secondly**, although multilateral aid agencies share this predicament of answerability to multiple principals, the EC is not quite like other aid agencies either. Political oversight in multilateral agencies (such as the World Bank or IMF) is typically exercised through executive boards, which are intermediary fora

in which there is at least some attempt to form coherent objectives through repeated interaction, and which are composed of full-time representatives of the member governments. The governments' often expressed anxiety that their representatives "go native" is precisely testimony to the fact that they seek compromises in the interest of a more coherent overall policy. But the main pressure on EC accountability comes through the Council, which is composed of serving politicians whose main focus is on their domestic interests. They spend too little time on EC affairs to come under any significant pressure to "go native" (a criticism that tends to be confined to full-time Commissioners rather than part-time Council Members).

- **Thirdly**, a combination of budgetary pressures and the intrinsic character of the challenges involved mean that a large part of the EC's external aid programme has taken the form of technical assistance for the purpose of fostering institutional reform. Success and failure in this area are notoriously hard to measure even by the standards of aid programmes elsewhere, a fact that has profound consequences (as we shall see) for the nature of the work the EC can reasonably be expected to carry out.

The difficulties faced by the EC in the management of its aid programmes have been well documented, and have indeed acquired considerable notoriety recently³. To some extent, a focus on questions of fraud and illegality can divert attention from other difficulties, such as the extent to which EC aid is achieving its objectives (a characteristic of the output of the process rather than its inputs). Indeed, to the extent that a focus on inputs may worsen the quality of scrutiny of outputs, procedures designed to tackle fraud or illegality might make some of the difficulties described above more severe. The recent Report of the Committee of Independent Experts identifies says, for instance, of the appointment of M. Berthelot by Commissioner Cresson that "the work performed was manifestly deficient in terms of quantity, quality and relevance. The Community did not get value for money"⁴, but recommends that "the human resources allocated to internal

³ See Committee of Independent Experts, "First Report on Allegations regarding Fraud, Mismanagement and Nepotism in the European Commission", March 15, 1999, available at www.europarl.eu.int/experts.

⁴ Ibid., para 8.1.35.

auditing be greatly increased"⁵, a measure that increases attention to financial accuracy without doing anything to augment quality, relevance or value for money. The overall impact of such measures will depend to a considerable extent on whether scrutiny of inputs and scrutiny of outputs complement or substitute for one another in the day-to-day work of aid officials.

Are such problems avoidable? It is striking that the more general complaints made about EC aid echo across studies of aid agencies everywhere, in kind if not always in degree (see Cassen et.al., 1994⁶). This suggests that comparative evaluations of different agencies may help to illuminate the extent to which such problems are inevitable, and the extent to which they may be capable of being resolved by intelligent organisational design. A particularly interesting and thorough documentation occurs in a number of studies of the World Bank⁷, as well as in the Bank's own Oral History Program. The case of the World Bank is all the more telling since it has enjoyed more than most agencies an access to high-quality technical expertise and has been subject to a need to justify its performance before sceptical national shareholders. The Bank's case is particularly interesting for the EC because of the nature of its answerability to multiple member governments; it should not surprise us if the phenomena uncovered in the Bank studies appear in the EC to an even greater degree.

The extent to which the measurability of success and failure determined priorities is a recurring theme of the Bank studies. Mason & Asher (1973), for example, note that "the Bank recognized [during its first twenty-five years] that investments of many kinds were needed for development but frequently implied that one kind was more essential than any other...projects to develop electric power and transport facilities were accordingly considered especially appropriate for Bank financing. At the same time the Bank was led to eschew certain fields traditionally open to public investment, even in the highly-

⁵ Ibid., para 9.4.16.

⁶ The question whether aid works has of course spawned a vast literature, much of which qualitatively supports the kinds of observation made here, but which differs according to whether the authors regard this state of affairs as inevitable or deplorable. See, for example, Browne (1990), Chambers (1983), Lal (1983), Lele (1990); Lipton & Toye (1990); Mosley, Harrigan & Toye (1991).

⁷ Mason & Asher (1973), Kapur et.al. (1997).

developed free-enterprise economies: namely, sanitation, education, and health facilities. Investments in these so-called ‘social overhead’ fields were widely considered to be as fundamental to development as are investments in hydroelectric sites, railroads, highways and ‘economic overhead’ programs. The contribution of social overhead projects to increased production, however, is less measurable and direct than that of power plants” (pp.189, 150).

When one senior bank official was asked in 1961: “Doesn’t it really in fact turn out that the Bank...puts a great emphasis on specific projects partly for public relations reasons and partly...to satisfy the market...[that] the Bank’s bonds are tied to something physical which can be seen and pointed to thereafter[?]”, he replied “Yes, I would agree?”⁸.

This is not to say that the Bank has only recently paid attention to the less tangible sides of development. For example, although “institution-building” is often thought of as a recent fashion, it has been a central component of many World Bank loan agreements since the early 1950s (Kapur et.al., vol.1, p.103). Nevertheless, it was typically a component of a project that had been selected for its overall ease of monitoring – and in the implementation it was easy for that component to be overlooked except insofar as it contributed to the aggregate measurable outcome.

What has changed substantially over time is that the targets and aims of Bank lending have multiplied. Writing of the 1980s and early 1990s, Kapur et.al. write:

“Meanwhile, trying to enforce multiple preconditioned policy targets was sapping the seriousness of the Bank’s adjustment lending. It was a kind of Catch-22. Targets had been added to adjustment exercises because they were good causes and it was administratively easy to do. But procedurally the choice had been for pre-conditioning: borrowers entered into fairly precise contracts to do or not to do things that were sufficiently measurable for nonperformance to be conspicuous. Review after review of

⁸ Cope, Oral History, 1961, cited in Kapur et.al. (vol.1, p.124).

adjustment lending wrung its hands over the proliferation of borrowers' agreed undertakings. In the Second (1990) Review of Adjustment Lending (RAL)...the number of undertakings per adjustment loan was up to fifty-six, and it continued to rise. There was no way so many simultaneous agreements could be monitored, let alone enforced" (vol.1, p.30).

At the same time as having to undertake multiple tasks evaluated according to multiple criteria, the Bank has been answerable to multiple constituencies. Many particular loans have been made – or blocked – because of pressure from shareholder governments. To take some early examples, Kapur et.al. note nine World Bank loans to Nicaragua between 1951 and 1956 due to the “highly convenient” relationship between Washington and the Somoza family⁹; the fact that “a loan to Iraq was rushed through the Board in 1950 [because] British relations with Iraq, and access to its oil, were at stake”; the reversal in 1956 under US pressure of an earlier decision not to open a line of export credit to Iran; and continued obstacles to lending to Indonesia because of Dutch objections to its expropriations of foreign assets¹⁰.

These examples suggest that even multilateral aid agencies can reproduce within themselves some of the problems of co-ordination that have been noted by Cassen et.al. (1994, esp. p.184) for the separate activities of bilateral donors. They argue that the obstacles to co-ordination between donors are that

- “co-ordination is likely to impair the freedom with which donors can pursue their commercial and political interests through their aid programmes”.
- “donors know there are subjects on which they are likely to disagree, particularly in the matter of development policies”.
- “co-ordination can be costly in administrative time and expense”.

⁹ p.103. See Lake (1989), p.103.

¹⁰ pp.104-106.

The consequence is a “proliferation of aid projects and of equipment types...The results of this are very commonly a large number of projects which the recipient is ill-equipped to manage”. If this is true of the actions of bilateral donors it is also true of the outcome of the pressures exerted on multilateral agencies by their multiple constituencies. Nevertheless, such agencies can often do better than bilateral ones in precisely the areas where procedures are open to easy monitoring – for example, in the implementation of “relatively transparent and internationally competitive bidding procedures for procurement”¹¹.

None of these observations necessarily imply (and none are intended by their authors to imply) that aid agencies are necessarily falling below some reasonable standard of behaviour. These features of their procedures may be the inevitable predicament of a large bureaucracy whose sponsors are not its beneficiaries (a description would encompass large non-governmental organisations as well as public aid administrations). But how can we assess such a claim, and what scope for organisational improvement might such a claim concede? To answer this question it is necessary to look more closely at recent developments in the economic theory of organisational design.

Although it is nearly a century since Max Weber first introduced bureaucracy as a serious subject of study, the formal analysis of bureaucratic organisations (including both large firms and non-market organisations) is still in a very underdeveloped state¹². It forms part of the more general theory of incentives under asymmetric information, that is of circumstances where individuals need to be motivated to act in certain ways even though their actions cannot be perfectly monitored and enforced. The reason why the formal theory is still underdeveloped is that it is still young. It dates from the 1970s, and has come to be known as principal-agent theory. It considers the relation between one party (a *principal*) who has an interest in the performance of a certain task (such the management of a firm, the farming of a piece of land, the undertaking of a bureaucratic task) – and a second party (an *agent*), who has to undertake the task directly and must be

¹¹ Cassen et.al. (1994), p.205.

¹² Though see Downs (1967) for a readable and interesting account of bureaucracies.

motivated to do so in the principal's interest. In the case of aid agencies we can think of two types of principal-agent problem: one is that the administrators have to be motivated to work in the interests of the funders. The other is that both funders and administrators claim to be working in the interests of the ultimate beneficiaries, but need to be given credible incentives to do so. Finding the right incentives is at the heart of the principal-agent problem.

Principal-agent theory has yielded some powerful insights in many applications, but its usefulness for the study of bureaucracy has only just begun to be explored. Its early applications were to circumstances where the principal had simple and clear goals (profit or output, say), and the other party (an agent) had to undertake a single task. The focus was therefore on the intrinsic effects of the divergence of interests between the parties, in the presence of asymmetric information. However, most large bureaucracies have to undertake a range of tasks, and many pursue what are in effect multiple goals, as the discussion above of the EC's predicament has illustrated. Yet since many of the most interesting incentive problems arise precisely in large organisations it has been common to draw inferences from simpler models, without any rigorous basis for knowing when such conclusions are likely to be robust.

More recent work in the theory of incentives has been exploring the consequences of relaxing the various limiting assumptions of the simple principal-agent model. The next section of the paper will review the literature on multiple agents, and the literature on multiple principals, which is the formal way of representing the predicament of an agency subject to conflicting pressures from many constituencies. These multiple principals could be thought of as the different shareholders of the World Bank, or the 15 member states of the European Union who impose multiple pressures on their common agent the European Commission. Then I shall consider an issue closer to the problem under investigation, namely the question what happens when a principal requires the performance of multiple tasks. A recent important paper by Dewatripont et.al. (2000) will be described in some detail, and then I shall develop a model designed to capture some phenomena that Dewatripont et.al. do not consider. These will turn out to be of particular

importance for organisations that have to decide the emphasis to be given to several tasks in the context of developing a career structure for the agents concerned.

Two particular features characterise the problem of how to perform multiple interdependent tasks - that is, tasks in which the performance of one is affected by how well the other is performed, either because the two tasks compete for the time or other inputs supplied by the agent or because one of them is in some sense an input into the other (that is, they may be substitutes or complements). *First*, the tasks may differ in the ease with which their performance can be monitored – one might require simply financial indicators while the other might require overall impact assessments. We have already noted how pervasive has been this problem in the activities of the EC and the World Bank, and other agencies are little different even if the phenomenon has yet to be so minutely documented. *Secondly*, the interdependence of these tasks means that incentives for the performance of one will affect the performance of the other. Under some circumstances, the more thoroughly the second task is performed the harder it will be to perform the first. For example, one task may be the preparation of grant or loan proposals, while the second may be the screening of the same proposals. The more rigorous the screening the fewer proposals may be left to go through. Under other circumstances, though, the performance of one task may enter positively into the production function of the other. For example, the first task may be institution-building while the second is the operation of some physical infrastructure: the better the first task is performed the easier it may be to perform the second. In this example, the first task is the harder to monitor but the converse is also often observed. The first task might consist of supply of some physical inputs while the second consists of operating those inputs in a way consistent with the needs of beneficiaries: the first can be observed quite precisely while the satisfactory performance of the second is much harder to establish. Indeed, one possible explanation for the so-called “inputs bias” in the implementation of aid programmes may be that this latter structure of aid tasks is more common than the former.

While as a general rule these features are simply given by the intrinsic nature of the task concerned, there may be circumstances where a given ultimate objective (poverty alleviation, say) can be accomplished with more than one structure of tasks, in which case the particular character of the complementarity or substitutability of tasks becomes a matter of choice for the organisation concerned. For example, one consequence of the use of compensation in kind rather than in cash for tribal groups resettled as a consequence of the Narmada dam project in North-Western India has been a typically low quality of land available for resettlement. As Satyanarayana (2000) reports, this has been because requiring government agencies to be responsible for disbursement of (easily monitored) budgetary outlays as well as for the quality of land purchase (which is hard to monitor) has led them to devote disproportionate attention to the former task at the expense of the latter. In these circumstances cash compensation (which allows the individuals to be responsible for their own land purchase and enables government officials to concentrate on a simpler task structure) would have been preferable.

To summarise, this paper is structured as follows. Section 2 reviews the literature on multiple agents, and the literature on multiple principals. Section 3 discusses the nature of multiple tasks and describes a model due to Dewatripont et.al. (2000). Section 4 outlines the main model of this paper. Section 5 concludes.

2. Multiple agents and multiple principals

2.1 The costs of delegation

One of the principal findings of the principal-agent literature is that in the presence of asymmetric information between the principal and the agent there will be unavoidable costs of delegation of a task – costs over and above the minimum necessary to compensate the agent for the effort of undertaking the task in the first place. These costs fall into two broad categories:

- When there is moral hazard (the agent cannot commit to an efficient action), the agent will have to be exposed to more risk than would otherwise be desirable, in order to give him incentives to work in the principal's interests. He will therefore need to be compensated by a higher average payment than would be necessary under complete information, in order to compensate him for the additional risk. Thus the director of an agency may have to resign if the agency fails to meet its targets, even if it cannot be demonstrated that this was the fault of the director; the director needs to be given an incentive to lower the risk of such an eventuality even if it cannot be altogether eliminated.
- When there is adverse selection (the agent has private information prior to signing the contract) the principal must give him an incentive to reveal this information correctly. This constitutes an informational rent, which lowers the return to the principal compared with what she would receive under complete information. Thus, for example, expatriate employees of an international agency may need to be given standard “hardship allowances” for foreign postings even if in some postings they may be substantially better off as a result – otherwise they will have an incentive to exaggerate the hardship of the particular circumstances they face.

It is by now well known (see Mookherjee, 1985) that when several agents work on behalf of one principal, these delegation costs can be reduced if the principal takes

account of any correlation in the uncertainty faced by different agents. The way this can be achieved is by using “yardstick” performance comparisons. For example, “yardstick regulation” uses the correlation between the shocks affecting the production costs of several regulated firms to devise rules for determining the movement of a price cap. A firm is rewarded not for its absolute success in reducing costs but for its success relative to the costs of other firms¹³. Similarly, comparison between the performance of different project directors in somewhat similar circumstances may make it easier to tell to what extent adverse performance on any one project was due to bad luck as opposed to bad management. If one project did badly while others facing similar shocks did well it is more likely to be a failure of management. Another example is the presence of a number of different agencies answerable to a major general organisation such as the United Nations: recent management failures in UNESCO were able to be addressed by pointing to the fact that these were not the inevitable consequence of being a UN agency, as the superior performance of other UN agencies demonstrated.

Whereas the presence of multiple agents has a fairly unambiguous effect on improving information flows (subject to the costs of administration and information processing), the presence of multiple principals has a more complex effect. Many interesting issues arise when an agent works on behalf of more than one principal. This may happen in one of two main ways:

- **Hierarchy.** A principal delegates a task to an agent who further delegates the task or some part of it to a subordinate. In this case the agent can be thought of as acting also as a principal with respect to the subordinate. This is a very common predicament for all large organisations, most of whose members are simultaneously seeking to provide incentives for their subordinates while themselves responding to the incentives of their superiors.
- **Joint delegation.** An agent works directly on behalf of two or more principals, each of whom has an interest in some dimension of the work performed by the

¹³ See Armstrong et.al. (1994).

agent, and the agent's performance in one dimension influences his incentives for performance in another. The situation of the EC's new Common Service is a case in point, but all the EU institutions are in some sense the result of joint delegation by the member states.

Most organisations of any degree of complexity contain elements of both hierarchy and joint delegation. We consider these in turn.

2.2 Hierarchy

There are three main ways in which the incentives in a hierarchy differ from those in a simple bilateral principal-agent relationship:

The Chain of Delegation

There is a longer "chain of delegation" which means there is potentially an efficiency loss at each stage in the chain, and the incentives of those further down the chain are further and further removed from those of the principal. Examples:

- The sponsors of an aid agency delegate its management to directors. But the directors cannot carry out all the tasks themselves so delegate them to subordinate staff. The directors seek to ensure staff act in the directors' rather than the sponsors' interests.
- Citizens delegate political action to elected representatives. The latter delegate it to a government. Scrutiny of the governments' actions is carried out by MPs rather than the citizens directly.

Here it is worth noting that the feature of aid agencies described at the start of this paper has a radical implication. Aid beneficiaries are not part of the constituency of the political owners of the aid agency: the chain of delegation is broken. Only the firms and consultants who provide inputs into aid programs are part of that constituency, and this fact will strengthen any pre-existing inputs bias in aid.

Intermediaries to Enhance Strategic Credibility

The principal can use an intermediary (a “manager”) to enforce a more credible set of incentives for the agent than she would be able to implement by herself. This is potentially beneficial to the principal. Note that sometimes the way in which this mechanism is made credible is through joint delegation with another principal, so hierarchy and joint delegation may reinforce each other in this respect. Examples:

- A multilateral agency may be able to resist pressure to make loans for purely political purposes than would the aid arm of a single country. The World Bank examples given above suggest that this will not always be successful (though they may also illustrate the dangers of having one or two dominant shareholders as opposed to a more balanced allocation of power). Nevertheless, Cassen et.al. (1994, p.215) conclude that on balance multilateral agencies “are largely apolitical” compared to bilateral donors. However, this conclusion appears more reasonable for those multilateral agencies that have genuinely delegated their management to an executive board than for those (like the EC) where responsibility rests in the hands of serving politicians from member states. One lesson may be that more genuinely devolved control may be necessary to diminish the extent of politicisation of EC aid (or, more accurately, of influence by the commercial interests of member states).

- Multilateral agencies may be able credibly to implement reasonably competitive and non-discriminatory procedures for tendering and procurement. EC experience suggests this may be easier (because it can be enforced by easily monitored auditing procedures) than diminishing politicisation in the choice of projects and beneficiaries¹⁴ - another revealing instance of inputs bias at work.

Manipulation by intermediaries

An intermediary can use the terms under which the agent is monitored in a strategic manner to improve her ability to extract concessions from the principal. This is potentially costly to the principal. It is likely to occur whenever the manager does not just play a role in a contract with the agent determined by the principal, but also has some influence over the terms of that contract. Examples:

- If the agent could be motivated by some combination of incentive payments and direct monitoring by the manager, the manager may choose more monitoring than is necessary, in order to increase his indispensability to the principal (see Anderlini, 1990). This may explain a tendency for aid organisations to be unnecessarily large from the point of view of their sponsors' interests. It also accounts for some of the phenomena described in Murrell (this volume), where contractors influence the terms of an aid contract to increase their own rent.
- If recruitment of the agent is the responsibility of a manager in an organisation, the latter may deliberately recruit low-quality people to prevent them from being promoted above him. Alternatively she may tend to avoid recruiting or rewarding those with scarce technical skills, whose promotion above her she may have particular difficulty in preventing. One way of resolving this difficulty is through the use of seniority-based promotion systems: these can be seen as a form of

¹⁴ Indeed, the Committee of Independent Experts has noted that "internal auditing...is generally satisfactory", while "a priori control [which] is embodied in the approval procedure...is very ineffective"

commitment device designed to reassure managers that they will not be threatened by recruiting high quality workers. In bureaucracies where the performance of workers is hard for senior management to monitor, and where they must depend on intermediate management for this information, this means that relatively inflexible seniority-based promotion systems are likely to be particularly common. This will somewhat mitigate, but will not avoid altogether, the adverse recruitment incentives just described.

2.3 Joint delegation

This occurs when an agent works in common for more than one principal. In addition to the obvious examples cited above, such as the answerability of the European Commission to 15 member states, joint delegation also occurs within large organisations. For example, the Commission has created a Common Service to manage the implementation of aid projects originating in several different Directorates-General. Joint delegation differs rather obviously from simple delegation in that the actions taken by the various principals to motivate the agent may impose externalities on each other. This is likely to result in various inefficiencies¹⁵, ranging from simple confusion over priorities to more systematic instances where the agent pursues a series of narrow goals instead of a coherent broad goal. For instance, an aid agency might fund a large number of inefficiently small projects to satisfy its various donors in turn rather than a smaller number of large ones. So why should it ever be in the interest of the principals to undertake joint delegation? What could be the compensating advantages (a fuller account of these is given in Neven et.al., 1998, chapter 3)?

(ibid., para 9.4.14).

¹⁵ More precisely, the agents' actions are not even constrained (second-best) efficient - they do not even maximise the joint surplus of the principals subject to the constraints of asymmetric information.

Coordination

The principals may be able to use the agent to co-ordinate their actions in a way that they are prevented from doing directly. One example from industrial economics is when the principals are two firms that are not allowed either to merge, to co-ordinate their pricing behaviour or directly to share markets (because of competition law).

Nevertheless, by using a joint distributor (for example) they can effectively ensure that this distributor coordinates their pricing and shares the market on their behalf (see Bernheim & Whinston, 1986). In the context of aid agencies, examples might include the following:

- Bilateral agencies may come under strong political pressure to use aid as a means of furthering competition for recipient countries' markets. A joint agency may be able to commit more credibly not to seek to do so; though, as the discussion above emphasised, it may not be easy to make this commitment stick.
- Where aid is tied to some general political goal that has multiple interpretations (such as the furtherance of democracy), a multilateral agency may be able to commit to avoid using aid to further particular political interest groups within the donor countries and concentrate instead on supporting more open political processes. The charter of the European Bank for Reconstruction and Development, for instance, includes a commitment to the furtherance of democracy, whereas many individual countries' aid programmes have been strongly tied to the fortunes of particular political parties. However, the example of Russia makes clear that multilateralism has not shielded the IMF and World Bank from considerable pressure to make loans to support President Yeltsin. Again the problem may lie with insufficient multilateralism rather than with multilateralism *per se*.

Commitment to the agent's incentives

The presence of one principal may be a means whereby the other principal can commit to an incentive structure for the agent that would otherwise not be credible. An example:

- A bilateral donor that tried to commit itself to using competitive and non-discriminatory procurement policies might come under heavy political pressure to favour its own suppliers, especially if domestic interest groups could claim that other countries were not doing the same. But the same commitment may be much easier to make for a multilateral agency, since each country can argue to its domestic interest groups that other countries insist upon non-discriminatory procedures. All countries may be collectively better off if such a commitment is reached (there is less waste in the overall aid budget), even if each country on its own has an interest in trying to favour its own suppliers.

Inefficiency as an ex post threat

The inefficiency of joint delegation may be used as a threat to give the agent a strategic advantage in negotiating with a third party (see Martimort, 1993). Examples:

- When President Clinton obtained “fast-track” authority to negotiate a GATT deal, this was time-limited so that other countries had an incentive to reach an agreement quickly, for fear of authority reverting to Congress (a set of multiple principals).
- Aid initiatives may be dispersed between agencies rather than concentrated in the hands of a single super-agency, in order to make capture by special interest groups more difficult. So various UN agencies in charge of children, health and so

on may face problems of coordination, but this may be thought preferable to undue concentration of power in the hands of a single agency.

Economies of scope

There may be important economies of scope between the activities performed for one principal and the tasks required by another. To get two agents to do the job would involve wasteful duplication of activity. However, the sharing of tasks creates some significant distortionary incentives. This is particularly true where the principals are not of the same kind (for instance, several member states), but rather involve quite different kinds of principal (for instance, a donor political authority and a set of beneficiaries, or a set of taxpayers and a set of consumers). One familiar day-to-day example of this kind of problem in joint delegation occurs in the medical profession, where doctors act simultaneously as agents for their patients and for whoever is paying for the treatment (typically an insurance company or the State). For the latter the doctor must certify the patient's state of health and therefore the level of resources to which the patient's insurance contract entitles him. For the patient himself the doctor must give advice as to the best way of regaining health given the resources available. The former task creates incentives for under-diagnosis, the latter for over-diagnosis. This analogy is very apt to aid agencies, for like doctors agencies work for the benefit of those who are typically not their paymasters. Specifically:

- Agencies typically act to report on the objective need for funding of various beneficiary countries. This is true not just in the high-profile cases of famine and natural disaster, where the reports of agencies on the scene are often the only available information about the scale of the disaster. More mundanely, it is the reports of agencies from their projects "one the ground" that provide the basis under which appeals for funds are made (to the public or to the political authorities).

- Agencies also, and obviously, act to further the interests of the aid beneficiaries. This is entirely proper, though it also creates incentives to lobby on behalf of the beneficiaries in respect of appeals for funds. And to the extent that agencies' budgets are dependent on the outcome of such lobbying, it makes agencies into natural allies of those who would exaggerate the objective funding needs in particular cases¹⁶.

Insofar as they act as agents of their sponsors, agencies may have an incentive to downplay the scale of difficulties in the beneficiary countries. Insofar as they act as agents of the beneficiaries they may have an incentive to exaggerate them (this has been a persistent theme of critics of foreign aid on the political right). Even if it might be better for sponsors and beneficiaries to have separate agencies representing them, the duplication of effort this would require would be thoroughly wasteful.

As this example indicates, assessing the efficiency of joint delegation is no easy matter, since it typically involves a trade-off between benefits (such as economies of scope, or improved credibility of commitments) and costs in the form of imperfect internalisation of the externalities between the principals. If we consider either solely the costs or solely the benefits it is easy to gain a misleading impression of the overall character of the joint delegation relationship.

A contrasting problem: multiple tasks

In the next section we consider a much more recent development of the simple principal-agent model, namely the extension to the case where the agent can potentially perform a multiplicity of tasks, but where some of these tasks are much more straightforward to monitor than others. This predicament arises in all large bureaucracies, and in that sense is by no means peculiar to aid agencies. But it arises in aid agencies in a

¹⁶ De Waal (1998) is a strong statement of this point.

particularly strong form, as we shall see. This is because aid agencies face even greater problems with monitoring the quality of work, because of the lack of direct feedback from beneficiaries in their structure of command and responsibility. This lack of feedback enhances the input bias that has already been discussed.

The basic foundations of this model draw on two sets of ideas. First there is the "career concerns" model of Holmstrom (1982), which shows what happens when agents are motivated not by direct monetary rewards but by the hope of demonstrating their abilities to some kind of professional labour market. This is particularly applicable to the case of aid agencies whose staff tend to be salaried rather than paid in a manner directly linked to ostensible performance. Secondly, there is the multi-task model of Holmstrom & Milgrom (1991), which demonstrates that when tasks compete for an agent's time and attention, incentives for the performance of one may affect the performance of the other. Specifically, incentives for easily-monitored tasks will need to be less high-powered than they would be in a single-task model, in order to avoid diverting the agent's effort away from other tasks. Indeed, this is the principal justification of paying agency staff fixed salaries: if not they would tend to focus on those aspects of the job that affected their salaries to the exclusion of other, perhaps more important tasks. As it is, the easily-monitored tasks tend to be those that involve the inputs into the aid process; the output-related tasks tend to be relatively hard to monitor. The presence of input bias in the aid process would almost certainly be exacerbated if agency staff were not paid fixed salaries. The model of the next section takes this idea a stage further by considering the determinants of a (constrained) optimal allocation of tasks.

3. A Model of Multiple Tasks

In this section we present the outline of a multi-task principal-agent model, due to Dewatripont et. al. (2000). In this model the principal is taken to represent either an organisation or a market that is interested in the talent revealed by an agent's actions, and will reward the agent according to the value of that talent (insofar as it can be inferred from observed behaviour). It is assumed that the agent is assigned to work on some number n of tasks (one of the purposes of the model is to show how the incentives for effort vary with the number of tasks). The agent begins by choosing an unobservable vector of costly actions $\underline{a}=(a_1,\dots,a_n)$, incurring private cost $c(\underline{a})$, and yielding a vector of observable outcomes $\underline{y}=(y_1,\dots,y_n)$. The result is a reward t to the agent, whose utility is this reward minus the cost of his actions $t-c(\underline{a})$.

This reward reflects the market's expectation of the agent's talent \mathbf{q} . Dewatripont et.al. show that in equilibrium, the marginal cost of the agent's actions will be set equal to the covariance of talent and the likelihood ratio. Put simply, this means that effort is higher when observed behaviour is more informative about the agent's talent.

Using this basic result, Dewatripont et al. go on to show (*inter alia*) the following:

- When only the aggregate performance on all n tasks together is observable, equilibrium total effort is decreasing in the number of tasks entrusted to the agent. They interpret this as implying a "benefit from focus", in that the performance of a more limited number of tasks increases the ability of the market to infer talent from performance
- In addition, under certain conditions governing the interaction of talent and effort, even when the agent focuses on a single task, effort is higher when the market knows exactly which task this is rather than having to infer it from observable outcomes. The authors interpret this as implying the superiority of giving clear rather than "fuzzy" missions to bureaucratic organisations. In the context of aid agencies it can also be

interpreted to mean that a degree of input bias is unavoidable, since clear missions are easier to define with respect to inputs (budgetary allocations, finance, contracts, experts) than with respect to outputs (project outcomes and impact).

- When tasks require different talents, it is better to group together tasks that require similar talents. This is interpreted as implying that it is better to employ specialists than generalists.

The results of Dewatripont et.al. are important and original, but they have one particular limitation. They demonstrate the benefits of specialization and of precision in bureaucratic organization, but they ignore their costs. Taken literally, their paper would imply, for example, that if only aggregate performance measures were available, each agent should undertake only a single task. Given that tasks for this purpose can be defined as narrowly as we please, this would imply a degree of specialisation against which Fordist production techniques would seem like dilettantism. And it would certainly imply that all aid agencies ever seen have been utterly disastrously structured for the nature of the tasks in hand.

So it is important to develop the insights of these authors by considering the nature of the trade-offs that have to be made in bureaucratic task design: what are the costs of specialisation to be set against the benefits? Describing this trade-off is the main task of the model in the next section. There we shall take seriously the idea that different tasks require different talents. However, talents may be correlated, and the performance on different tasks may be complementary. So too much specialisation is costly for two reasons. First, it does not exploit the fact that an agent who is good at one task may be good at another task that is complementary to the first. Secondly, it does not use the information revealed by performance on one task about the agent's talent for the other: in an organisation that seeks to use performance as a guide to promotion this agent will be valuable. The model will therefore be one with two periods, rather artificially

distinguished so that in the second, information is valuable purely for intrinsic task performance, while in the first it is also valuable for promotion.

4. A Model of Multiple Talents

In this section we present a simple model with multiple talents as well as multiple tasks. Unlike the model of the previous section it has two periods, thereby allowing us to examine not only the incentive problem in any given period but also the selection problem when a principal uses the agent's performance in the first period to determine whom to employ in the second. These two problems turn out to be inter-related, in that because promotion is desirable, the criteria of selection determine both the distribution of talent in the second period and the choice of effort in the first. In the context of aid agencies, the model therefore casts light both on the extent to which they concentrate effort on some tasks rather than others, but also on the kinds of skills and talents they seek to employ and the nature of the individuals they promote.

There is a single risk-neutral principal and a pool of risk-neutral agents. Adding risk aversion to the model would complicate the calculations without adding new insight. There are two tasks to be undertaken; each agent may undertake both tasks, or the agents may be allocated to them separately (not necessarily in equal proportions). We discuss below some interpretations of these tasks in the context of aid agencies; the model shows when it will be preferable to separate and when to bundle the tasks. Each task requires both talent and effort. In addition, output of the second task is potentially affected by the performance of the first. We can think of this as implying that the first good is an input into the production of the second, though it may not only be an input, in that it may also be valued in its own right. This is particularly significant in the context of aid agencies, since as is well known donors care about the benefits to their own contractors (consultants or suppliers of procured goods).

The tasks may be performed separately (one agent assigned to each task), or both

while that for the output task is:

$$(2) \quad y_2 = \mathbf{a}_2 \cdot a_2 (b \cdot y_1 + c_2)$$

where \mathbf{a}_i is the talent of the agent undertaking task i , a_i is the effort of the agent in the performance of task i , and b , c_1 and c_2 are constants.

When the tasks are performed together by both agents, the production function becomes (by substitution of (1) in (2)):

$$(3) \quad y_2 = \mathbf{a}_2 \cdot a_2 (b \cdot \mathbf{a}_1 \cdot a_1 \cdot c_1 + c_2)$$

Each agent is endowed with talents represented by an ordered pair $(\mathbf{a}_1, \mathbf{a}_2)$. Both \mathbf{a}_1 and \mathbf{a}_2 are assumed to have a uniform (rectangular) probability density. However, their distributions may be correlated, and indeed the extent of the correlation plays an important part in the conclusions of the model.

Neither the talent of the agents nor the output they produce is directly observable in the first period before the end of the game. Instead the outputs y_1 and y_2 are observed with a random error, so we can write

$$(4) \quad \tilde{y}_1 = y_1 + \mathbf{e}_1 = \mathbf{a}_1 \cdot a_1 \cdot c_1 + \mathbf{e}_1$$

and

$$(5) \quad \tilde{y}_2 = y_2 + \mathbf{e}_2 = \mathbf{a}_2 \cdot a_2 (b \cdot y_1 + c_2) + \mathbf{e}_2$$

We can interpret these errors in different ways. In particular, where \mathbf{e}_1 has higher variance, the *input* task will be particularly hard to monitor. Examples would include the task of quality control, or of impact assessment as part of the process of preparing aid

proposals. Where e_2 has higher variance, it is the *output* task that is particularly hard to monitor, such as the exercise of judgement in evaluating the significance of evidence collected through a routine procedure. An example would be the task of solving a crime: the input task is the comparatively routine task of interviewing witnesses and suspects, while the output task involves deciding which of the suspects is most likely to be guilty. In the context of aid agencies, the input task might be the collection of data about the financial performance of a project; the output task might be the exercise of judgement about whether these data really capture the most important of the project's effects.

Since there is no risk aversion in the model, the significance of the uncertainty about output is twofold. First, it reduces the likelihood that a given level of effort on the part of the agent will attain a particular level of any given task; it may therefore blunt incentives for effort. Secondly, it makes any given selection rule on the part of principal less capable of discriminating between agents of different talents. The impact of this is somewhat subtle, as will be seen below.

There are two periods, 1 and 2. In each period the principal chooses an assignment of tasks to agents. In keeping with the literature on bureaucratic organisations, it is assumed that in the second period the principal has no discretion to offer direct monetary rewards to the agent. Instead the agent is motivated by career concerns - that is, by the wish to demonstrate his talent to the market, which may consist of an internal labour market (such as within the European Commission or a national bureaucracy). The generosity with which the market rewards observed talent makes a major difference to the structure of incentives within the organisation.

Decisions in period 1 are taken bearing in mind their likely impact on behaviour in period 2, so it is important to work out their effects in period 2 first. The order of events in period 2 is as follows. First the agent decides whether to separate or to bundle the tasks. If the tasks are separated, principal decides what proportion of the agents to allocate to each task. Then the agents choose their effort levels, and the tasks are carried out.

In period 1 the principal has an additional decision to make. As well as assigning tasks to agents she can also choose a promotion rule in the form of a threshold level of performance for each task, above which agents will be selected for employment in period two. As will be seen, this possibility affects the assignment of agents to tasks: there will be an additional bias towards the task which is easier to monitor, since the “output” of this task now includes information that will improve performance in period 2.

The technical details of the model’s results, as well as the formal proofs, are explained in Seabright (1998); a further discussion of implications is in Seabright (2000). The main results are as follows:

- In the second period, it will be better for the principal to separate tasks if the output task is relatively hard to monitor, and if the skills required for the two tasks are not strongly positively correlated between agents¹⁷. Separation will also be better if the input task makes the output task more difficult (such as when the input task involves screening)¹⁸. The principal will tend to prefer bundling them if the output task is relatively easy to monitor, and if there is a strong positive correlation between the skills required for the two tasks.
- The principal will allocate agents between tasks in period 2 in order to equalise the marginal returns from the tasks.
- Agents’ effort on either task in period 1 is lowered if the tasks are hard to monitor, whether the tasks are separated or bundled. In other words, monitoring difficulties blunt work incentives.

¹⁷ This supports the reasoning in paragraph 9.4.16 of the Report of the Committee of Independent Experts, where it is stated that "A prior control and internal auditing are activities which employ completely different techniques and address completely different concerns. The arrangement whereby they have been kept together within the same directorate-general should be reviewed".

¹⁸ The result in this special case is consistent with an earlier result due to Dewatripont & Tirole (1997).

- Differences in ease of monitoring make no difference to the promotion rules in period 1. Promotion thresholds are chosen so that the same proportion of agents will be promoted from each task.
- Separation of tasks is more likely in period 1 than in period 2, all other parameters remaining the same between the two periods. This is because separation yields more information about agents' skills, information that is particularly valuable in period 1 because it improves selection.
- Under separation, a higher proportion of agents than in period 2 will be assigned to the low-variance task, both because effort is higher on the low-variance task and because the low-variance task is a more effective screening mechanism. This implies that more of the organisation's resources will be devoted to input-related activities.

These results have some striking implications for the allocation of tasks within an aid agency. First, they show that, to the extent that the skills appropriate to undertaking the different tasks of an agency tend to be correlated across individuals, these different tasks will tend to be bundled together even though it is known that this will tend to distort incentives towards an undesirable degree of focus on inputs and other routine activities. Financial appraisals will attract more attention than overall impact assessments, for example. Ensuring budgets are spent will take precedence over ensuring they are spent well. There will be a strong bias towards inputs that are easy to monitor rather than outputs that are not. Although, perhaps surprisingly, the promotion rules of an organisation will not be such as to set easier thresholds for those performing easily monitored tasks, they will direct more of the agency's staff towards undertaking those tasks.

What can we conclude? In a set-up like this one, we have seen that uncertainty (the difficulty of monitoring agents' performance) has an important effect on their incentives to exert effort, is irrelevant to determining the necessary rigour of a promotion rule, and

significantly affects the allocation of agents to tasks. We should expect a bureaucracy that takes these lessons to heart to allocate more of its members to input- than to output-related tasks, and more of them to routine activities than to those involving judgement and discretion. Likewise, its members themselves are likely to work harder at these input-related activities than at those where their performance, however intrinsically laudable, may fail to find an appreciative audience.

Figure 1 shows the intuition behind the first result. It shows effort as a function of talent, both when tasks are separated (broken lines) and when they are bundled (solid line). When talents are uncorrelated, effort is a linear function of talent, but when they are correlated it is convex. The convexity means that the expected effort levels under bundling may be higher than under separation.

Figure 2 shows the intuition behind the third result. The larger the range of the error term, the smaller the contribution of any given increase in effort to the probability that the agent will be promoted.

Figures 3 and 4 demonstrate the intuition behind the last three results. Figure 3 shows the unconditional density of talent α_i , and the density conditional on output lying above some level which would be produced by an agent of expected talent μ_i . This conditional density has a shape that evidently depends on the magnitude of the error variance. Figure 4 shows the impact of two promotion rules with expected talent cut-offs μ_i and μ_j , subject to different error variances. Suppose these lie at different levels, with $\mu_i > \mu_j$. Then the increase in the expected talent that comes from a marginal increase in μ_i must be smaller than the increase in talent that comes from a marginal decrease in μ_j (such as is necessary to keep the total numbers promoted constant. This holds true regardless of the error variances attached to the two promotion rules. Only if $\mu_i = \mu_j$ will the best expected talents be promoted.

However, the diagram also indicates that the expected value of talent conditional on the selection rule μ_i is indeed decreasing in the error variance. This means that low-

variance tasks when used as screening mechanisms, yield an output of promoted agents with higher expected talent than do high-variance tasks. So the allocation to the tasks will be distorted away from that which equalises the expected return to the two tasks by an amount reflecting the additional value of the low-variance as a screening mechanism.

It is now time to draw together the threads of the argument and to assess conclusions for aid agency organisational design.

5. Conclusions

Empirical studies of bureaucracy have often failed to distinguish between those aspects of bureaucratic behaviour that reflect poor organisational design and those that are unavoidable consequences of the kind of activity the organisation is obliged to undertake. Some features of organisations, though perhaps regrettable by comparison with an ideal world in which incentives would be unnecessary, are the inevitable result of the fact that individuals' behaviour cannot be precisely monitored. This paper has shown that a degree of input bias, and excessive emphasis on routine activities at the expense of those requiring judgement and discretion, is unavoidable in any organisation where different activities have to be performed but where there is a link between the talents required for different tasks. Separating the input tasks from the output tasks, and the routine tasks from those requiring judgement, would be too costly in terms of failing to exploit the links between these skills. Bundling the tasks together may be the lesser of two evils even though it inevitably leads to a misallocation of agents' efforts towards the inputs.

However, the paper has also shown some of the parameters that will determine the nature of this trade-off. Bad organisational design may get the balance wrong, and an awareness of the factors of importance may be of value in helping to escape the more avoidable shortcomings of bureaucracy.

So what lessons could be learned by aid agencies from the arguments in this paper? First let us consider the general arguments from the principal-agent literature:

- Aid agencies that are also public administrations will inevitably suffer from weak organisational incentives due to the particular difficulties of monitoring the results of the work they perform. These will be exacerbated by the absence of direct feedback from beneficiaries to the control mechanisms of the organisation. However, mechanisms to strengthen this feedback will be valuable.
- Both donor and recipient governments are themselves agents on behalf of their taxpayer-citizens, and should not always be presumed to have the interests of

these taxpayer-citizens directly at heart. Once again, mechanisms to strengthen the accountability of aid agencies to these taxpayer-citizens will be valuable (for instance by incorporating NGO feedback in recipient countries as well as feedback from governments¹⁹).

- The activities of aid agencies will tend to concentrate more on input-related tasks (budgets, contracts, personnel) than on output-related tasks where "success" is relatively difficult to demonstrate. This inputs-bias may be further exacerbated by some of the phenomena to be summarised below.

The main lessons from the literature on multiple principals would seem to be the following:

- Being answerable to a number of different constituencies will inevitably lead to some inconsistencies. The fact that sponsors and beneficiaries are not the same will make it difficult to give adequate weight to beneficiaries' interests. Specifically it will reinforce input-bias because donors benefit principally from inputs while beneficiaries benefit mainly from outputs. The presence of such difficulties should not be a cause of despair but should be seen as a challenge to minimise the problems they cause, and in particular to find ways to represent the interests of beneficiaries in the decision-making processes of the agency.
- The presence of multiple principals can also be a source of strength, provided it enables the agency to commit itself to procedures that would not be easy to implement for a bilateral donor. These include transparent and competitive procedures for tendering and procurement, and a commitment to avoid linking aid to narrow considerations of market access or the fortunes of particular political and economic interest groups. However, this commitment may be easier to deliver on the side of input procedures (tendering and contracting) than on the side of the preparation and selection of projects. This latter fact further reinforces the input bias already described. Mechanisms to mitigate it include more effective delegation of day-to-day aid management from the interests of donors, while

¹⁹ Nevertheless, it should not be assumed that all NGOs necessarily represent citizens' true interests either.

keeping donor scrutiny of more long-term strategic aspects of the agency's activities. The recent creation of the SCR in the European Union can be seen as a step in this direction, though arguably only a partial step.

- Multilateralism can also enable the exploitation of economies of scale and scope that are beyond the capacity of bilateral donors. This means that such agencies have a comparative advantage in the implementation of projects and programs that either require substantial technical expertise, or involve spillover effects between countries or sectors that bilateralism might have difficulty internalising. However, the large scale necessary to cope with such projects will also bring foreseeable inflexibilities, such as a relatively high dependence on seniority systems.

These lessons are not just pious injunctions, for they indicate that a multilateral agency that fails to exploit the benefits that come from the presence of multiple principals is actually likely to perform worse than would bilateral donors. If it cannot find ways to do so it cannot really justify its existence. In particular, transparency of decision-making is an even more important requirement for multilateral agencies than for bilateral ones²⁰.

What about lessons from the model of the paper? The main ones are the following:

- An agency will inevitably suffer from a degree of excessive focus upon routine activities; this is likely to include inputs bias, the selection of projects for ease of monitoring rather than overall contribution to beneficiary welfare, a personnel policy that recruits and directs staff to easily monitored tasks, and promotion rules that rely upon performance in these tasks even for selecting people for tasks that require more judgement.
- However, it is essential that an agency structure its activities so that it does not suffer from these behavioural characteristics more than is strictly necessary. This means, for example, bundling tasks together only if there is a significant

²⁰ A lesson, incidentally, that does not appear to have been appreciated by the European Central Bank...

correlation between the skills they require and not merely for administrative convenience.

- For example, unless financial evaluation of projects involves highly similar skills to those required for overall impact assessment, it is desirable to assign these tasks to different sub-units of the agency (the same argument applies to *ex ante* and *ex post* evaluations). Similarly, tasks involving searching for projects should not be performed by the same units responsible for quality screening of those same projects. Project selection and project auditing should be the responsibility of different units.
- Separation of tasks is even more important for relatively junior members of an agency, because of the greater information about their skills that such separation yields. Too much generalism among junior staff makes it harder to allocate them subsequently to responsible positions in the organisation.

To be sure, this is a rich field, which has only recently come to be explored using the tools of incentive theory. There remain many important questions for future work to explore. Nevertheless, one general message remains very clear. Input bias, and a focus on routine tasks at the expense of those requiring discretion and judgement, are here to stay. But their prevalence can be restrained, and the tools of incentive theory provide a number of useful rules of thumb to enable such restraint to be exercised.

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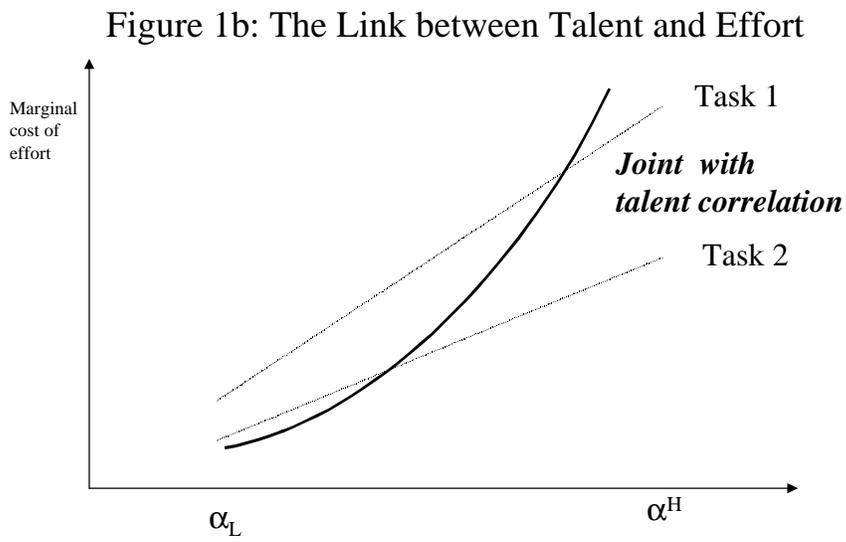
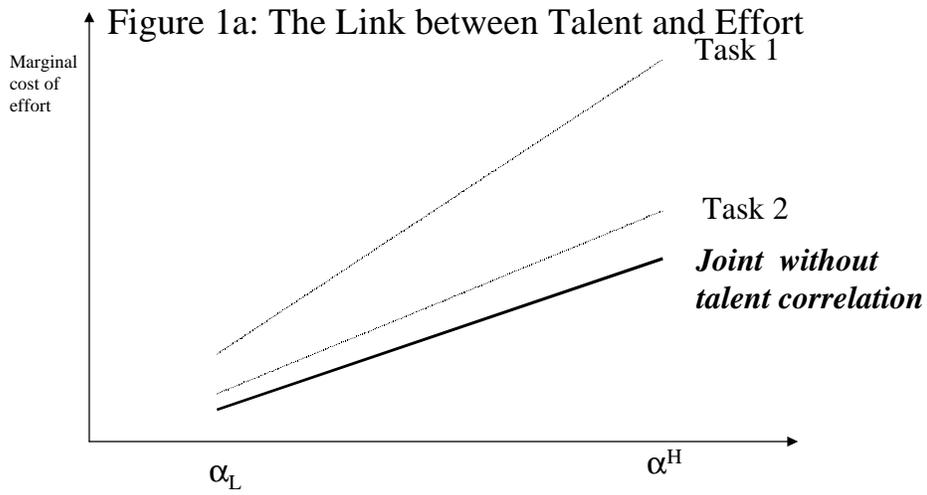


Figure 2a: The Importance of Uncertainty for Effort
- difficult monitoring

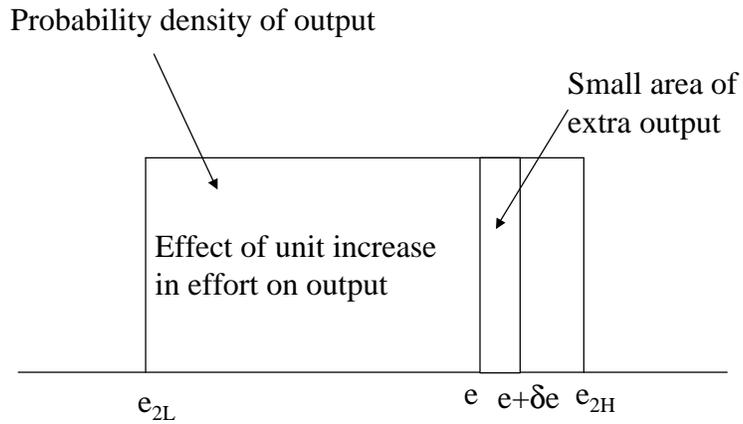


Figure 2b: The Importance of Uncertainty for Effort
- easy monitoring

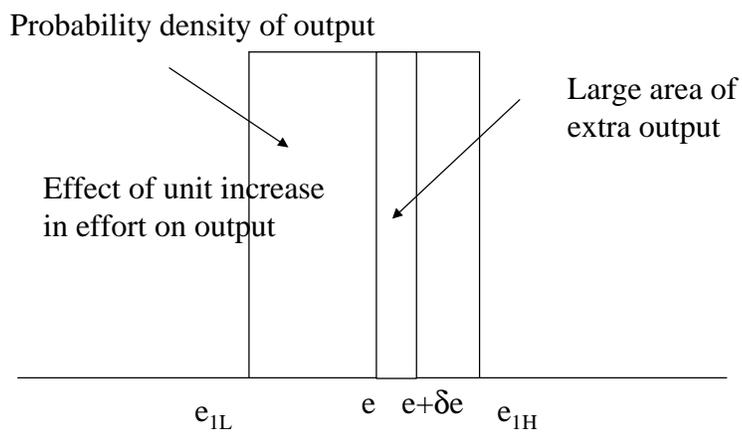


Figure 3a: The Irrelevance of Uncertainty for Selection

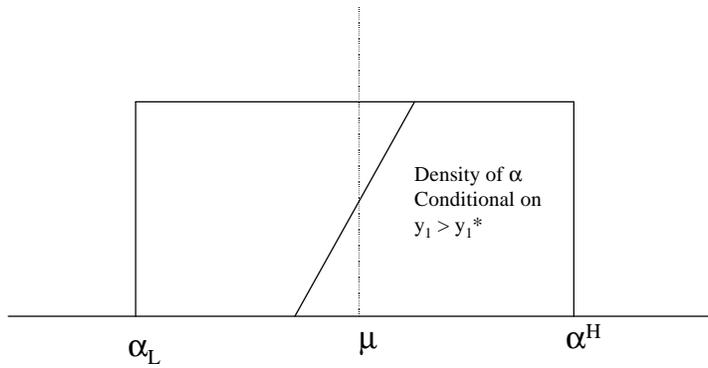


Figure 3b: The Irrelevance of Uncertainty for Selection

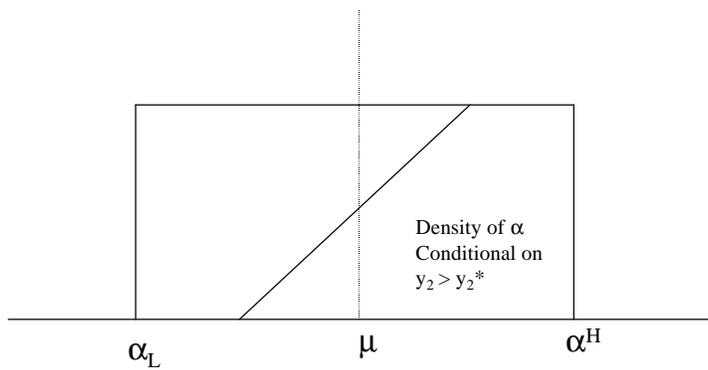


Figure 4: The Irrelevance of Uncertainty for Selection

