

Whither EC Aid?

Briefing note: Budget support

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The increasing use of Budget Support in development aid – Is the EC (and the EU as a whole) moving into the right direction?

About this Briefing Note

'Whither EC Aid?' is an independent, joint ActionAid-ECDPM project that aims to contribute to a broader based common understanding of the characteristics, added value and impact of EC development cooperation. After the finalisation of an initial discussion note, the project has entered a consultation phase to stimulate further inputs from stakeholders. Three briefing notes are being issued reflecting the main topics which have been raised in the workshop discussions, these being (1) budget support; (2) the treaty of Lisbon; and (3) division of labour. The briefing notes aim to raise awareness and inspire further analysis on the respective topics, and can be downloaded at <http://weca-ecaid.eu>.

In the framework of the activities carried out so far stakeholders have clearly stated the need for increased dialogue on the EC's increased commitment to budget support. This briefing paper aims to contribute to clarifying the main issues raised in our workshops around the potential benefits and risks of budget support as implemented by the EC. It is hoped that this briefing paper can contribute to improving the general level of understanding about Budget Support and identify means to improve its implementation.

Definition

The EC defines budget support (BS) as the transfer of financial resources of an external financing agency to the national treasury of a partner country. Broadly speaking, budget support involves the direct **transfer of funds to a partner country's budget**. These financial resources form part of the partner country's global resources, and are used in accordance with its public financial management system. Budget support is one tool in the toolkit of EC aid modalities. There are two main types of budget support: General Budget Support (GBS), representing a transfer to the national treasury in support of a national development or reform policy and strategy; Sector Budget Support (SBS), representing a transfer to the national treasury in support of a sector programme policy and strategy.

Where do we stand?

Budget support is **increasingly used by donors to channel their development aid**. The EC is leading this trend and further ahead than most other donors, in line with the European Consensus on Development and the Paris Declaration. Internally, the European Union has agreed to reach 50% of EU ODA through budget support by 2010. In part as a result of this commitment, the EC will use budget support under the 10th European Development Fund (EDF) in 44 African-Caribbean-Pacific countries compared to 28 countries under the 9th EDF. Significant European donors are also intensifying the use of BS in their bilateral development aid. It is important to note however, that various forms of BS still accounts for a relatively low proportion of global aid, and it is highly unlikely that European donors will reach their stated target of 50% of their ODA through BS.

Benefits and risks of budget support

The advantages of budget support, compared to project aid are usually stated as follows: BS is more predictable, it supports nationally-owned poverty reduction strategies (PRS), it helps governments to expand public services, and it fosters State and administrative capacities. It is also argued that BS can help support stronger ownership of aid inflows and can lead to stronger systems of domestic accountability.

The EC clearly states that its aim in increasing BS is to help recipient countries to become independent from international aid. The EC argues that channeling aid through government systems will necessarily contribute to their reinforcement, leading ultimately to economic growth and development. It is clear that with benefits also come several **risks** especially with governments that do not have reliable Public Financial Management systems or institutions able to effectively tackle corruption. There is also a potential risk for BS to create situations which reinforce the power of donors in the budget and overall policy arena in a partner country. In this respect the advantages in terms of increased predictability can equally turn into risks of excessive volatility for political rather than fiduciary reasons. BS can risk giving excessive power finance ministries to the detriment of other (sectoral) line ministries or parliaments. These risks and benefits are assessed in more detail further on in this note.

It is also worth noting that partner countries have hugely differing views on BS: while several Eastern Africa countries have embraced the idea, several others including South Africa and India oppose it for various reasons (fear of donors teaming up and increasing dependence; preference for targeted project support for areas where they lack capacities, etc.)

Why does the EC favour BS?

Greater use of budget support is viewed by the EC as a key instrument for advancing the aid effectiveness agenda and improving its aid delivery. Therefore, in line with the 2005 European Consensus on Development and the Partnership commitments of the Paris Declaration 2005, budget support is one of the EC's preferred aid modality. The added value of the EC in the provision of BS is generally accepted by the donor community; it is highlighted by the OECD/DAC Peer

Review of EC aid: "Budget support may be an area where the Commission has a comparative advantage over many Member States, given its experience and accumulated know-how".

The EC sees BS as part of a bigger picture; contributing to the effective implementation of nationally owned poverty reduction and growth strategies by filling the gaps in national budgets, while at the same time providing an incentive to improve public services delivery and support to Public Financial Management systems. The argument is that the provision of a significant level of external finance is an essential part of supporting the transparent management of resources and further provides a solid basis of fiscal revenue. In summary the EC's position is that:

- Governments are essential actors in combating poverty and delivering development. Because budget support uses government systems it helps strengthen them;
- In the right circumstances, budget support helps governments deliver core functions: building financial and political stability; stabilising the macro economy; supporting delivery of basic public services such as health and education;
- Budget support can enable governments to be accountable for its actions and responsive to its citizens

The EC provides BS to the countries that meet the following general criteria of eligibility: having a national policy and strategy (sector policy and strategy for SBS); a stability-oriented macroeconomic framework; a credible and relevant programme to improve Public Financial Management. There are many questions as to who actually sets these criteria, with widespread criticism of the rigid application of "macro-economic policy criteria" in particular.

The global agenda: EU's focus on aid predictability

In the Third High-Level Forum on Aid Effectiveness in Accra in September 2008, the EC is proposing to the EU Member States as a group to focus on improving predictability of aid through BS and the so-called MDG contracts. The MDG contracts are intended to be a distinctive implementation modality for general BS, allowing provision of support for a

	January	February	March
International process		<p>International Forum on CSOs and aid effectiveness to prepare for Accra arranged by Advisory Group on Civil Society and Aid Effectiveness (AG), Guatineau, Québec, Canada (3-6 Feb)</p> <p>Aid Effectiveness discussion in DEVE on the follow up or the Paris Declaration (26 Feb)</p>	<p>European Council, Brussels (13-14 March)</p> <p>15th ACP-EU Joint Parliament Assembly, Ljubljana (15-20 March)</p> <p>First draft of the Accra Action Agenda</p> <p>EURODAD - GMF roundtable on aid effectiveness, Brussels (18 March)</p>
WECA process	<p>Roundtable at DG Development, European Commission, Brussels (17 Jan)</p> <p>Wilton Park conference "European Development Policy: Aid Effectiveness and Key Priorities", UK (21-24 Jan)</p> <p>Roundtable at the Netherlands Ministry of Foreign Affairs, the Hague (30 Jan)</p>	<p>Roundtable in Dublin, Ireland (4 Feb)</p> <p>Roundtable in Madrid, Spain (22 Feb)</p>	<p>Roundtable in Kigali, Rwanda (3-4 March)</p> <p>Roundtable at AidCo, European Commission, Brussels (12 March)</p> <p>Roundtable in Colombo, Sri Lanka (13 March)</p> <p>Workshop on Budget Support with EC and EU NGOs, Brussels (27 March)</p> <p>Roundtable at Sida, Stockholm, Sweden (31 March)</p>

timeframe of three to six years with a focus on results, performance assessment and reinforced dialogue instead of immediate suspension of disbursement. The EC claims that the MDG contracts offer greater predictability, allowing for long term planning for social sectors recurrent costs. A pilot scheme is about to be launched in some 10 countries,

Overall, workshop participants have had positive reactions to the proposed instrument insofar as it aims at better linking budget support to MDG impact through predictable long term aid allocations. Additionally, participants have expressed

support for the idea that MDG contract would act as a tool for monitoring the impact of budget support on the MDGs targets under PRS, whereas in the past, donors have taken (uncoordinated) positions towards freezing their budget support because of political or economic instability, corruption, cases of late disbursements, etc. On the whole though, there is a need for more transparent and clear information about how the scheme will work in practice, and a better understanding of the accompanying measures being used to better support domestic accountability measures.

A case study: Rwanda

Aid from European donors to Rwanda is mainly channeled to the government, a high-level of which through budget support. The EC will channel 60% of programmed funds under the 10th EDF envelop for the country (or €131.4 million out of a total budget of €219 million for the period 2009-2013) through budget support. Another main donor, DfID (UK), has already been providing high-levels of BS and is expected to continue this support with a level of around £35 million per year (€54 million).

At workshops held in Rwanda in March 2008, a high degree of support for BS was expressed, which raises the question: What can make budget support work? Lessons learned from the Rwandan experience:

- ✓ The articulation of reliable monitoring instruments and a serious and credible MDG-oriented poverty reduction strategy are essential to create a favourable environment for donors to endorse and support the priorities decided to by the Rwandan authorities.
- ✓ BS evaluation relies on the (national) Economic Development Poverty Reduction Strategy (EDPRS) monitoring framework: the common Performance Assessment Framework (CIPAF).
- ✓ The EDPRS has been developed closely in line with the MDGs, which makes it straightforward for donors to back.
- ✓ Strong Government agenda setting and leadership, its capacity to be accountable to donors and to Rwandan society, excellent working relationship, dialogue and harmony in the relationship between the Government and main donors, all combining efforts and pursuing the same agenda, as well as a high degree of coordination between donors, are key elements according to all local stakeholders.
- ✓ An innovative mechanism, the Joint Action Forum, is in charge of addressing coordination gaps amongst NGOs and government interventions.
- ✓ One last lesson to learn from Rwanda's experience: policies towards decentralisation and district level accountability.

Lack of human capacity and low absorption capacity are the main challenges. Stakeholders must ensure that budget support and related implementation and monitoring systems are working efficiently in order that aid is being absorbed.

Also worth noting, Rwanda is a pilot country for the MDG contacts. Previously, €30 million GBS were disbursed annually depending on a series of indicators. Now, disbursement of aid is made predictable over 6 years and monitoring will be against the MDGs.

International process	OECD-DAC Working Party on Aid Effectiveness and Donor Practices meeting, (2-3 April)	GAERC with development focus (26-27 May)
	EC communication outlining the EU contribution to the HLF in Accra in September	ACP-EC Council of Ministers session (end of May)
WECA process	Regional Preparatory Events leading up to HLF in Accra: Organised by Regional Development Banks, UNDP and other interested partners	Regional Preparatory Events i leading up to HLF in Accra: Organised by Regional Development Banks, UNDP and other interested partners
	This is taking place: <ul style="list-style-type: none"> • For Pacific Island countries, Fiji (4-7 April) • For Southeast Asian countries, Bangkok (21-22 April) • For African countries, Kigali (28-30 April) 	This is taking place: <ul style="list-style-type: none"> • For South Asian countries, Bangkok (5-6 May) • For Central and West Asian countries, Bangkok (8-9 May) • For Central and Latin American countries, Washington (19-23 May) • Middle East countries, date tbc
	Roundtable in Rome, Italy (15 April)	Briefing notes on Budget Support, Division of Labour and on the Lisbon Treaty (First week of May)
	Roundtable with EU MEPs, Brussels (17 April)	
	Roundtable in Copenhagen, Denmark (21 April)	
	Roundtable, Banjul, Gambia (28-29 April)	
	<i>April</i>	<i>May</i>

Issues and challenge arising for the EC in effectively providing BS

Although regarded as technical, there is a clear need to demystify budget support as an aid modality. There needs to be a democratisation and transparency in the communication about how budget support will support the delivery of EC and partner country development objectives, especially in partner countries. Below is a summary of the key challenges around securing the potential benefits and minimising the risks associated with Budget Support.

• Domestic Accountability and ownership

A recurring concern in our discussions was the risk that Budget support increases the power of the donor community at the expense of domestic accountability. Lack of transparency regarding both partner government budget and aid flows is an issue and it is essential that local populations are enabled to hold their governments accountable for the use of budget support aid.

The workshops have shown a great deal of consensus on the need to accompany budget support through measures to strengthen various stakeholders. In other words, the EC must accompany BS with increased support for institutions of domestic scrutiny : national parliaments but also the media and civil society organisations (CSOs). Discussions have also pointed to the need for the EC to pay special attention to groups that are affected but excluded from debates on the (women organisations, rural civil society groups, etc.). Although certain cases have been cited where parliamentary hearings looking at aid inflows and national budgets have been successfully organised (Mali, Sierra Leone), national parliaments still face severe lack of information as well as the skills needed to engage effectively. Parliaments are also key stakeholders to advocate for citizens concerns in the planning and delivery of national budgets. Measures to accompany the **institutional development and administrative capacities** of the legislative and judiciary scrutiny organs (Court of Auditors, parliamentary Commissions, etc.) –also have to be part of a budget support strategy.

Finally, there is also a broad consensus on the importance of **accompanying decentralisation and strengthening local authorities** through budget support. Bring the aid at the local level is indeed a means to increase the aid effectiveness and visibility. This is a huge challenge considering the difficulty to grasp the mechanisms and

channels through which the whole range of stakeholders – local authorities, the civil society, the media, etc. – would finally get the benefit of the aid.

• Alignment and conditionality

As long as BS is tied to nationally-owned strategies and systems then it should contribute to improving ownership and alignment in aid. However, these benefits can be undermined by heavy handed donor interference and conditionalities which limit the government's ability to negotiate appropriate policies. Because Budget support gives donors the right to look at all strategies and priorities set up in the national budget there is a clear risk that this level of access and power can undermine the sovereignty of a beneficiary country. One of the EC's eligibility criteria for BS is to have a "stable macroeconomic framework". **IMF controversial conditions and signaling instruments** (the Country Policy and Institutional Assessment for instance) are widely criticised for rigidly imposing a particular economic policy, closing down the space for partner governments to determine their own economic policies and giving the donor community excessive political if not ideological leverage.

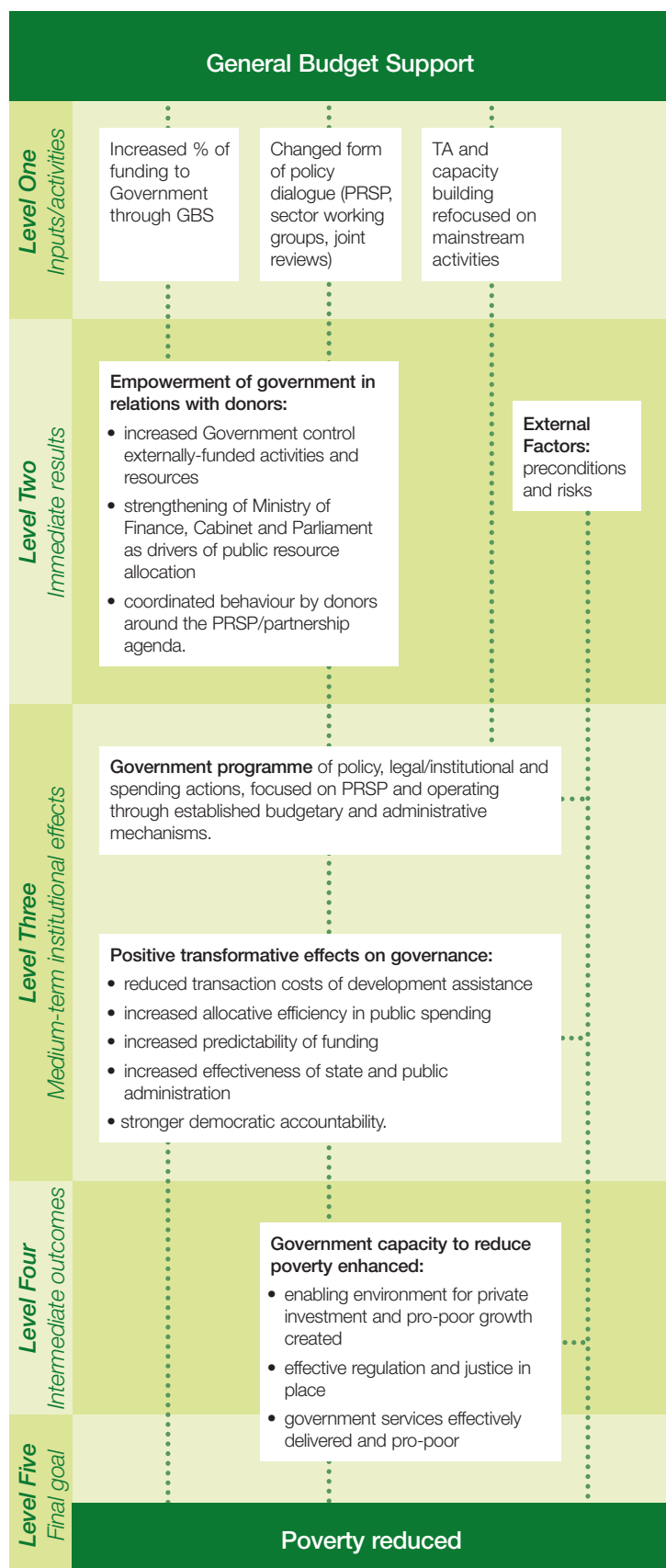
Workshop participants have also raised concerns in relation to the **incentive tranche mechanism**, a component of the EC's **Governance Initiative** embracing a range of good governance criteria defined by the EC. Incentive tranches are provided to partner countries in response to the levels of ambition and credibility of an action plan set up by the recipient government. This allows in practice the EC to condition its aid on the achievement of agreed country-owned indicators of good governance. The application of the Governance Initiative remains vague and CSOs demand transparency in the definition of the criteria and insist on the importance that these criteria be mutually-agreed and binding between the EC and partner countries.

• Coordination, dialogue and monitoring for impact

Although the EU has committed in the Consensus on Development to align and harmonise their procedures and practices, there is still much to be done to improve harmonisation amongst European donors, in alignment with partner country policies and procedures. This is especially crucial if BS is to deliver on its promise to strengthen national procedures, rather than re-creating a cacophony of competing performance management frameworks, eligibility criteria etc. One potential advantage of budget support is that

International process	European Council, stocktaking of report on MDG progress, Brussels (19-20 June) Final draft of the Accra Action Agenda (June-July)	Start French EU Presidency OECD-DAC Working Party on Aid Effectiveness and Donor Practices meeting (2-3 July) EuropeAid Annual Report 2008 to be published	CSO special forum on the HLF, Accra (31 Aug – 1 Sept)	Third High Level Forum on Aid Effectiveness, Accra (2-4 Sept) EC annual report on EU aid levels before Accra meeting
WECA process				Final Report and Launch Event
	<i>June</i>	<i>July</i>	<i>August</i>	<i>September</i>

Table: Evaluation Framework linking up GBS and poverty reduction



Source: OPM/ODI Synthesis 1

it places aid within a wider policy context and can potentially result in improved coordination. In this respect, the EC (at Delegation level) has a role to play in creating space among donors for improving the transparency of programming, evaluation and assessment methods.

Greater donor coordination at local level is essential to avoid excessive and overlapping monitoring and evaluation missions. This is particularly necessary when systems around budget support are not pooled between donors at local level. Budget support coordination groups work depending on the degree of involvement of donors and their willingness to support the leadership of partner countries in these groups. On the basis of existing experiences the **openness** of these groups to all stakeholders – parliamentarians, media, civil society organisations, private sector, etc. – is a key factor in the successful implementation of BS. Indeed, donor failure to provide accessible information to the public about their activities and government failure to publish audited accounts undermines efforts for better monitoring of aid impact. Bringing **more clarity and transparency** into these fora and the surrounding decision-making structures could facilitate the assessment of the results of budget support. Crucially this can also promote more accountable and transparent budget processes overall in a country.

Finally, **more dialogue and independent perspectives** on the impact and outcomes of budget support aid is lacking.

• **EC structural problems**

The technical implementation of BS by the EC should not overlook key features of a successful budget support operation which must be a basis criteria accompanied by broad-based policy dialogue. This dialogue necessarily includes the establishment of a real partnership between donors and recipient countries. There is a question mark regarding the **EC capacity and mandate to engage in more political questions** involving the supervisory role of parliaments, power relations between line ministries and ministries of finance, interaction between national and local levels of authorities, etc. This level of authority and capacity is however needed in order to really obtain the full development benefits of budget support. **Stronger EC expertise in sector policies** is also needed.

Greater reliance on budget support requires systematic use of risk assessments and a good understanding of the appropriateness of budget support in the local context. EC headquarters should rely more on the experience and assessments of delegation staff as well as the inputs of national parliaments and civil societies in designing and managing budget support.

• **Predictability and the MDG contract**

If BS is not accompanied by a commitment to predictability the political consequences can be severe. The lack of sanctions on donors if they do not deliver on promises seriously undermines the notion of mutual accountability.

The **MDG contracts have received mixed reactions** so far. Discussions are ongoing and, although the EC would like to make this a cornerstone of its contribution to the debate on aid effectiveness, there are concerns that a consensus amongst the EU Member States could not be reached before Accra.

The added value of the MDG contracts in reaching the MDG targets still need to be demonstrated. There is also a specific issue regarding predictable budget support in **Fragile States** (or even non-Fragile States like in recent time Kenya), where there have been cases in the recent past of postponement of aid delivery due to concerns about the political situation (Sierra Leone in 2007).

- **Different perceptions of budget support**

There is a risk that the budget support approach will squeeze out alternative approaches and actors, reducing the amount of aid available to civil society and other actors as compared with the project approach.

It is important to ensure that the moves towards budget support are accompanied by additional **measures to support the instruments of accountability and innovation**. Some commentators have spoken of the need for a tool box of different approaches and modalities to support the poverty eradication strategies.

The increasing use of budget support is perceived by some stakeholders as an easy way for donors to ease disbursement rates with a view to meeting the Monterrey commitments (i.e. on the volume of Official Development Aid

– ODA). However the clear view in the workshops has been that budget support is not an easier aid modality compared to project or sector approaches and in practice rather requires much resources and time in monitoring but also in engaging in sensitive political dialogue with the partner countries.

This briefing note has been written by Romain Philippe. The author would like to thank those EU officials and CSO representatives who provided comments on an earlier draft of this document.

Further reading

Analysis on budget support from the OECD/DAC and the Good Practices Guidelines on budget support, available under: www.oecd.org/dac/evaluation

International Development Department of the University of Birmingham, "A Joint Evaluation of General Budget Support 1994-2004" (2006). See the report under the DAC Resource Evaluation Centre: http://www.oecd.org/findDocument/0,3354,en_35038640_35039637_1_35074430_1_1_1,00.html

Volker Hauck, Oliver Hasse and Martin Koppensteiner (2005), "EC budget support: thumbs up or down?", ECDPM Discussion Paper 63, Maastricht. Available under: www.ecdpm.org/dp63

For the issue of budget support and corruption, see:

U4 Anti Corruption Resource Centre (2005), "Direct budget support and corruption", downloadable from: http://www.u4.no/pdf/?file=/document/u4-issue/u4_issue1_2005_budget_support.pdf

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