

## The future of EU budget support to third countries?

Report of the consultation with experts from Civil Society Organisations on the EU Green Paper on Budget Support (Brussels, 13 December 2010)

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### Introduction: Why this consultation and why this report?

*"Budget support is coming under increasing scrutiny as a means of providing aid. Unfortunately, many of the common criticisms owe more to donor risk aversion than to flaws in budget support, while other more valid criticisms are not being adequately researched and discussed."* Geoff Handley's comments are as valid now as they were two years ago<sup>1</sup>. The use of budget support is under pressure because of questions about the impact and results of this aid modality, questions also about quality and value for money. The Court of Auditors, the European Parliament, and civil society have all raised critical questions about budget support, with some EU Member States interrupting or reducing their budget support programmes or shifting to other aid modalities when political or other crises emerge in partner countries. To respond to these questions, and to open the debate about how to improve the approaches to budget support, the European Commission (EC) has launched a consultation process on the future of budget support.

In this process, the then DG Dev requested ECDPM to facilitate a consultation seminar. With the financial support of the Belgian Directorate General for Development, ECDPM was able to mobilise at short notice experts from think tanks, academia and NGOs for a one-day seminar with the EC. The main purpose was to ensure that independent experts got a platform to share and discuss the findings, evidence and

<sup>1</sup> Handley, Geoff (2009). [\*Are We Asking the Right Questions? A Brief Overview of Recent Literature on Budget Support\*](#). D+C, April 2009, Inwent.

experiences related to budget support<sup>2</sup> that emerge from research, evaluations and country and sector level experiences EC experts. There was a swift and positive response from the experts in NGOs, think tanks and academia that ECDPM approached to participate in the one-day consultation seminar with the EC.

This Briefing Note summarises the most important responses from twenty independent experts, who shared and discussed their views with EC experts on 13 December 2010 in Brussels. Given the rather unique composition of participants and the scope and depth of the discussions, the authors of this note have tried to capture and summarise the core arguments and discussion points to share it with a broader audience.

The structure of the EC Green Paper on the future of budget support lent itself well for the structure of the one-day seminar. So this report also uses the seven key issues that are dealt with in chapter four of the Green Paper<sup>3</sup> to cluster the questions and answers of the discussions.

## Report of the experts' consultation on budget support

The publication in October 2010 of the EC's Green Paper on *The future of EU budget support to third countries* marked the beginning of a broad consultation process on this topic. The Green Paper is informed by work undertaken by a technical EU working group that brings together experts from the EC and EU Member States. The process involved multilateral organisations, country based meetings with EU delegations, EU Member States, civil society organisations and partner country governments. On 13 December six EC experts met in Brussels with twenty independent experts or researchers from academia, think tanks and Non-Governmental Organisations. The discussions revolved around the seven core issues and the sets of questions that the EC's Green Paper identifies. EC representatives introduced these issues, clarified the questions and provided additional information in the course of the consultation. These inputs are summarised in the boxes. The arguments and inputs from participants have been summarised, without attributing them to their *authors*.

Based on the consultations, the EC will publish an *Issues Paper*, which will feed into the process of developing an EC Communication on budget support, expected to be finalised by mid 2011. This Communication will accompany the broader Communication on the modernisation of EU Development Cooperation.

### 1. The role of political dialogue

It is widely acknowledged that political conditionality is not an effective tool for leveraging political change. Yet, donors react more strongly to concerns about political governance when they provide budget support. These sensitivities or concerns about political governance issues increasingly result in a number of EU Member States interrupting, reducing or stopping their budget support. In such circumstances, the attention shifts from the development agenda to the political elements that underpin the budget support arrangements between partner country and donors. These include democracy, the rule of law, the universality and indivisibility of human rights and freedoms and are usually integrated as *Underlying Principles* in the Memorandum of Understanding on budget

<sup>2</sup> "Budget support must be more than a financial transfer – it is part of a package including policy dialogue, performance assessment, capacity building and other supporting interventions". *Green Paper*, p 6

<sup>3</sup> This report uses the concepts as these have been used in the Green Paper, so readers may want to consult the document for it contains useful definitions and background information to the important issues related to budget support that have emerged over the last decade.

support between donors and the partner government. Whereas in the past these Underlying Principles were not directly related to the conditionality framework underpinning the budget support, there are demands to make budget support conditional upon a country's respect for these political principles.

Questions include:

- *What to do with budget support when there are major breaches or partial deteriorations in Underlying Principles (principles of human rights, democratic principles and rule of law)?*
- *Should budget support programmes contain more political governance conditionality?*
- *How to deal with the ever-growing political pressures in donor countries from home constituencies?*

Most of the suspensions of or reductions in budget support during the last five years relate to donor assessments of and decisions related to deteriorations of Underlying Principles. Underlying Principles are integrated in a *Memorandum of Understanding*. Donors often view and interpret these principles differently. Most often, the Underlying Principles are not clearly related to the conditionality framework of budget support, nor are they openly discussed among donors or between donors and the partner country government. These flaws and the lack of transparency make it difficult to assess, determine and agree when 'breaches' or 'violations' of the Underlying Principles occur.

Underlying Principles should be transparently discussed with the partner government, clearly defined and adapted to the particular context. Similarly, donors and partner governments need to agree on what constitutes 'breaches' or 'violations' of these principles, as well as on response mechanisms. In Tanzania, for example, media reports on corruption resulted in different responses from different donors. So donors in a particular context often differ in their understanding or appreciation of evolutions on issues related to these Underlying Principles. They may also differ on what is needed to strengthen or support these principles.

One participant argued in favour of a clear link between these Underlying Principles and political conditionalities, since the obligation to respect human rights is universally accepted. Hence, this should be reflected in binding commitments from partner governments and should be linked to conditions in the budget support mechanism. Other participants highlighted the difficulties related to such a position and the lack of results. Budget support is a financial support instrument for ensuring development benefits. However, some donors also use this aid modality as an instrument to promote 'political governance' objectives. They do not prioritise sufficiently and 'overload the boat'. Donors, it was argued, seek to realise too many objectives through budget support. They find it hard to apply a hierarchy and instead try to pursue both sets of objectives at the same time. The issue about the Underlying Principles boils down to the question whether these principles are a minimum requirement for all aid, or merely for budget support. Is good political governance a condition for budget support? Or do donors seek to promote these principles through budget support over time?

Donors give increasing attention to these Underlying Principles in a number of partner countries. This attention results in all sorts of action plans, roadmaps, dialogue, meetings, etc. Yet there is little tangible proof of further implementation or impact beyond the plans and the various inputs. Solidifying or extending the conditionality framework of budget support will not change much. In fact, most participants agreed that political conditionality does not work, and were sceptical about linking the conditionality framework of budget support to political governance dimensions of the Underlying Principles.

Despite the rhetoric, some donors may even be not that much interested in the effectiveness of political conditionality in the field. It was felt that such conditions and the prospect of being able to visibly halt,

interrupt or reduce budget support were primarily a response to demands from donor constituencies for signs of donor disapproval over real or perceived violations of Underlying Principles.

In that sense, budget support is more 'vulnerable' than other forms of aid to pressures in donor countries. Donors perceive it as an easy target. One participant argued: *"It should be avoided that budget support is used for political games"*. However, the mood in a number of donor countries is such that the public support for budget support will further wane if a positive link with political governance processes cannot be made.

More importantly, political change has to come from within the partner countries, and cannot be imposed from outside. Better knowledge among donors of local context, the politics, institutions, change dynamics and margins of manoeuvre may help set realistic objectives and improve the quality of the political dialogue. Such dialogue can also be more effective if non-state actors are better informed about what donors do, especially in the area of budget support.

When budget support donors want to express dissent with a partner government in case of (perceived) violations of Underlying Principles, they often resort to posing an ultimatum to the government: either the partner government reforms, or budget support is suspended. Such suspension is an extreme measure that cannot be used repeatedly without losing credibility. Such measures also defeat core purposes of budget support such as predictability and (macro economic) stability. So it is important to study intermediary and incremental measures or steps. Political dialogue should be part of a more transparent process of negotiation.

In order to preserve some of the positive features of budget support and reduce the negative effects of suspension thereof, there may be value for donors to reflect on differentiated donor approaches. In countries where bilateral donors might opt to stop their budget support, the EC and other multilaterals could ensure continuity and thus avoid an abrupt disruption of financial flows. Some EU Member States have already expressed the view that bilateral and multilateral donors ought to have the choice to respond in a differentiated way to particular situations, while others are not in favour of such an approach.

## 2. The role of policy dialogue, role of conditionality, and links to performance and results

Policy dialogue is a key component of budget support. It complements political dialogue, but is distinct from it in that policy dialogue does not focus on the Underlying Principles but on a country's development related policy and budget processes. Policy dialogue may help set common expectations as well as a framework for monitoring results, and may help donors to a better understand the objectives and capacities of a partner country government. Key challenges related to policy dialogue include the scope of this dialogue, the expertise and skills required, the role of conditionality, and how to strike a balance in the performance assessment framework between policy reforms and results indicators. Most EC budget support programmes combine both result and policy indicators, which serve as a focus for policy dialogue.

- How can policy dialogue be improved?
- What is the relevance of the indicators used?
- Is there an appropriate mix of indicators?
- Do they create appropriate incentives for partner country governments?

Policy dialogue as part of the budget support package has demonstrated results, especially where EU staff added value in terms of providing strategically relevant policy advice, identifying options for sequencing reforms, or removing constraints. Policy dialogue that facilitates reform is possible in a context where the

government is open to reforms. In fact, policy dialogue works best when objectives/interests from donors overlap with those from developing partners. Evaluations suggest that the influence of donors on policy choices of partner government's is rather limited – and often different from what donors expect or want. There are a few positive examples of effective policy dialogue in areas where sector budget support has been applied. But evaluations have also shown that budget support has supported poverty reduction spending and service delivery results.

There are numerous dysfunctions with policy dialogue, and multiple reasons for it. On the donor side, there is a lack of coordination and harmonisation, as well as capacity constraints in EU Delegations and other development partners. There are also weaknesses on the part of the recipient countries including capacity constraints and lack of political will. There is a tension between dialogue and the principle of ownership, which touches on the notion of *partnership* that underpins the budget support process. Donors have different interests and are motivated by differing incentives, not only from partner country governments, but often also from one another. They want or need to demonstrate their value added to their domestic 'constituencies'. Often, they think to know better than the partner country government. This may disrupt budget support and defeat its objectives. Where there is a communality of views between donors and partners dialogue policy dialogue can help find ways to tackle for example service delivery problems related to quality and use of services. Evaluations of budget support in Eastern European Countries demonstrated that policy dialogue has been useful in facilitating and sequencing reforms.

Participants also pointed to confusion about the definition or the delimitation of policy dialogue. Donors largely steer and use it in different ways. Often, dialogue is reduced to setting targets and monitoring. Defining indicators and targets in the Performance Assessment Framework is a joint exercise of donors and government. While there are efforts at harmonisation, some donors still prioritise their own concerns at the dialogue table and put different emphasis on the type and on the mix of process and results indicators. Problems are compounded when donors disregard the degree of domestic buy-in for certain policy priorities or reforms.

So, the dialogue process tends to turn into demanding and lengthy discussions about indicators, targets, and data gathering or monitoring mechanisms and practices. In terms of monitoring, donors use the policy dialogue for checking whether certain conditions for budget support are fulfilled or respected; *"what the EC describes as dialogue is actually monitoring"*. Overall, dialogue is often more about donor priorities than about sector or country related objectives or development. Such practices crowd out more substantive dialogue on issues of a more strategic nature in the various budget support working groups. In sector budget support more attention needs to go to issues of a crosscutting nature or to dialogue that address bottlenecks in for example service delivery failures around improved sets of indicators.

But such meaningful policy dialogue demands new skills. It requires from the donor side a solid mix of sector and cross-sector capacities. Now the emphasis tends to go one-sidedly to public finance management. It was stressed that the EC needs to strengthen its country specific expertise as well as the expertise to work in particular sectors. Other capacity constraints relate to the high turnover rate of EC personnel, and the lack of incentives to invest seriously in policy dialogue, to properly coordinate with other donors, and to reduce the number of 'people around the table'. As one participant observed: *"I've never seen a silent partner that is truly silent"*. It would also help if monitoring and dialogue were not lumped together. By treating them as separate meetings serving different purposes, one may avoid a dialogue that is contaminated by conditionality concerns. *"If donors only bring conditions, they will be kicked out of the room"*. Also from the side of the partner country government there are weaknesses in the policy dialogue<sup>4</sup>.

<sup>4</sup> See ECORYS study on experiences in Benin, Burkina Faso, Cameroon and Senegal: Van Linde, M. 2008. [\*Appui budgétaire sectoriel dans le pratique: synthèse et enseignements de l'analyse de quatre études de cas au Bénin, Burkina Faso, Cameroun et Sénégal\*](#). Rotterdam: ECORYS.

Remarks were also made about the lack of inclusivity in terms of participation by a broad range of actors in the policy dialogue, often excluding line ministries, local authorities, national parliaments and civil society. Useful lessons on policy dialogue can be drawn from the *Learning Assessments* that are undertaken in the context of the *Strategic Partnership with Africa*<sup>5</sup>. These assessments include annual reviews of how partners are dealing with each other, of the size and content of the Performance Assessment Frameworks, and the quality and the effectiveness of the policy dialogue. This valuable independent learning process and instrument, however, may be discontinued.

In the post-Lisbon architecture with the *European External Action Service* being rolled out in the field, there are opportunities to ensure greater coordination and harmonisation in policy dialogue between EC and EU Member States. This would imply a stronger capacity to analyse the political economy constraints in the context in which the EU Delegation operates (country, sectors, problem areas).

### 3. Domestic and mutual accountability

Domestic accountability tends to be weak in many developing countries. Donors engage a lot with one another in budget support processes, but what about commitments towards and interactions with national parliaments, supreme audit institutions, and civil society organisations?

The lack of engagement with Parliaments and Supreme Audit Institutions is acknowledged and as such, represents one of the challenges identified in the Green Paper.

- *How can the EC reinforce domestic accountability, taking into account what other stakeholders have to offer, or what roles they can play?*

The discussion focused mainly on 'domestic accountability'. There is no common understanding among donors on how to strengthen domestic accountability. Case studies in Ghana, Tanzania, and Burkina Faso for the European Parliament<sup>6</sup> underlined the importance of a solid – and a more shared - understanding of domestic accountability institutions and systems.

Generally speaking, there has been more attention and support for Supreme Audit Institutions than for other accountability institutions such as parliaments, civil society actors, media etc. Parliaments, especially the Public Accounts Committees, also receive some donor attention, but this tends to be uncoordinated. There is a need for more in-depth knowledge about how parliament functions and could function in a particular context. The *Public Expenditures and Financial Accountability* (PEFA) assessments usually provide useful information on the overall public finance management system. Yet there is also a need for a deeper understanding of the politics in a particular context, as well as the incentives or obstacles for parliament to fully play its different roles (law making, representation, but especially checks and balance role). This may help better define context specific contributions to strengthening accountability systems without overburdening them<sup>7</sup>.

Donors also support civil society organisations. Increasingly, CSOs are being supported for their contributions to scrutinising the budget process. But this raises the question of how much support CSO should receive, and how this support should be provided. Should there be a fixed amount, for example a percentage of total budget support being set aside for CSOs? Participants warned for a too rigid approach and pointed to the potential for providing core - and coordinated - funding to certain CSOs. Additional forms

<sup>5</sup> <http://www.spa-psa.org/main.html>

<sup>6</sup> European Parliament. 2010. [Monitoring budget support in Developing Countries. A comparative analysis of national control mechanisms.](#)

<sup>7</sup> See also Hudson A. and GOVNET. 2009. [Background paper for the launch of the works-stream on aid and domestic accountability.](#)



of conditionality have to be avoided. Donors should refrain from determining with whom partner country governments have to sit at the table. Too many of them also is not helpful and “kills the discussion. It is not the business of donors to insist who the government should talk to.”

Again, more fine-grained and context specific diagnostics should help refine and calibrate support strategies for CSOs. Such analysis can also help define the menu of tools within the broader context in which donors provide budget support. Financial support, however, may not be the only or the most important obstacle hampering CSO participation or involvement. Donors can help CSOs too by improving transparency on their own overall aid efforts. Often the agreements donors sign with partner governments, such as the EC’s Millennium Development Goal Contract, cannot be found on websites. Donors can also reduce the burden on CSOs or improve effectiveness by pooling their resources in support of CSO participation in budget support discussions or dialogue, as the case of Zambia illustrates.

Investigative journalism in Tanzania illustrates that targeted support to the media can contribute to transparency. Media reports on corruption resulted in a public outcry and donor responses. Yet, the long-term impact of such actions is not always clear.

Three more considerations were brought to the attention of donors that engage in budget support. Countries receiving budget support generally perform poorly on the *Open Budget Index*<sup>8</sup>. This invites the question whether donors should not insist on a minimum level of transparency with their partners when they provide budget support. Secondly, as the Green Paper rightly points out, donors also have to develop a stronger focus on domestic resource mobilisation in the context of their work on budget support. Thirdly, donors can add more value to the budget support process in support of domestic accountability by being more transparent about their aid.

Finally, this transparency principle also raised the question what donors are doing in terms of strengthening mutual accountability. One promising area of work is the specific *performance assessment framework* that focuses on donor behaviour. In countries such as Mozambique, Rwanda, Burkina Faso and Ghana donors and partner country governments have agreed on a donor specific PAF that lists commitments and performance targets by donors. On an annual basis, donor performance is monitored against commitments of aid effectiveness.

#### 4. Programming of budget support and its coherence with other instruments

When programming budget support, the EC focuses strongly on checking the eligibility of countries to budget support and comparing the benefits with the risks. As yet, the EC does not have a classification or ranking of those benefits.

The Court of Auditors<sup>9</sup> has criticised the EC for lack of criteria with which to choose the level of budget support to be allocated. Increasingly both general budget support and sector budget support are used in parallel (in the ENPI region, 28% of total budget support is set aside for sector budget support<sup>10</sup>, whereas ACP countries mainly receive general budget support). Both forms of budget support are used in combination, but coherence is not always assured.

EU Member States are increasingly using sector budget support, since they consider this form of budget support to be less sensitive to political governance issues.

- What are the criteria that determine the volume of budget support?

<sup>8</sup> The International Budget Partnership produces the [International Budget Survey](#) with the Open Budget Index,

<sup>9</sup> European Court of Auditors. 2010. [The Commission’s Management of General Budget Support in ACP, Latin America and Asian countries](#). Special Report N.11.

<sup>10</sup> See also Williamson, T. and Dom, C. 2010. [Sector Budget Support in Practice. Good practice Note](#). ODI, Mokoro,

- What informs the choice or the mix between sector and general budget support?

The discussion was mainly about the appropriate mix of general and sector budget support. The differences between these two forms of budget support relate to the type of interlocutors, the type of focus of the dialogue and monitoring, the sort of objectives, and their entry points and history. In the case of general budget support, the main interlocutor is the Ministry of Finance, whereas for sector budget support, the prime interlocutors are the sector ministries. Mali and Senegal illustrate well how sector and general budget support can be used simultaneously in a coherent way. The ways to ensure such coherence will be country specific. Relationships and balance of power between the line ministries and the Ministry of Finance differ in Francophone and in Anglophone countries. This will have to be taken into account in the way that policy dialogue on general and sector budget support is structured.

The question is not whether to use general or sector budget support, but rather how to design general and sector budget support. Generally speaking, this question should be answered with all donors collectively. Usually, bilateral donors want to give less discretion to recipient countries, and increasingly favour sector budget support since that is easier to sell back home. The EC should use its aid to complement or counterbalance aid of EU Member States. The EC also needs to spread its support over different aid instruments – the *portfolio approach* – to mitigate risks and use each instrument for the purpose it is suited for. Aid effectiveness arguments may be in favour of more general budget support. Yet, as one EC expert put it, “*the winds draw us more to sector budget support*”. Donors moving into sector budget support should look at issues that cut across sectors and should ensure linkages with the Ministry of Finance. It is important to also make sure that sufficient sector specific expertise is made available once a donor shifts from the general to the sector budget support.

Some donors prefer sector over general budget support as they want to give less discretion to recipient countries. Indeed, sector budget support provides opportunities for influencing through dialogue, monitoring and technical working groups.

One concern relates to the number of sectors in which donors seek to apply sector budget support within the context of Sector Wide Approaches. There is a danger of inflating the transaction costs and overburdening often weak capacities within partner country governments. In the end, one cannot have ten different sectors in which donors seek to engage with government. In Mali, there is general budget support plus sector budget support in three sectors (health, education and decentralisation). And this already creates problems. In Mozambique there are more than fourteen working groups related to sector budget support.

This raises the issue of coordination and division of labour in programming at a higher level. The Green Paper on the future of budget support refers to the European Union, but in reality it is more narrowly about dealing with the European Commission. So is this process an opportunity for the EC to take a lead in programming of budget support for or with the EU Member States as a whole? The Green Paper, it was explained, seeks to promote a more coordinated approach to begin with, while a ‘common approach’ for the time being is too far fetched.



## 5. Strengthening risk assessment and dealing with fraud and corruption

All forms of aid carry risks, not only budget support. The Green Paper takes a broad look at risks, and includes political, development, and fiduciary risks. The Court of Auditors has been critical on how the EC assesses, prevents and manages or mitigates risks. Specific weaknesses the Court identifies relate to fiduciary risks, and insufficient attention to corruption.

- How can the EC improve risk assessment?
- What measures should the EC take when the risk levels are considered to be too high?

It was recognised that the EC has a different approach to risks than the Court of Auditors and some EU Member States. The EC has made good progress in assessing risks. As all aid modalities carry risks, it is appropriate to undertake the risk assessment at the level of the country systems, rather than focusing only on budget support. There is no empirical evidence confirming that risks associated with budget support are higher than with other aid modalities such as projects.

Moreover, budget support is the only modality that enables participating donors to have discussions with the partner country government on abuses of donor (and partner country) funds. As such, it can be argued that budget support provides opportunities to combat corruption. Another important and often ignored link between budget support and corruption is the potential for donors to contribute to strengthening domestic accountability systems – including parliaments, civil society, the media, etc. – and thus contribute to risk reduction. As one participant put it: *“Donors cannot prevent corruption from happening in partner countries. That is why they need to strengthen domestic accountability”*. Or put in another way: *“Budget support, in a way, is to deal with fiduciary risks by means of using and strengthening national accountability systems.”*

The EC pointed to the confusion between fiduciary risk and financial responsibility, and to the difference in interpretations of *fiduciary risk*. Once the conditions are met, the EC disburses its money. The EC’s financial responsibilities end there. For the Court of Auditors a fiduciary risk is the risk related to EC disbursements not being used for the intended purposes. For the EC such a risk is a *development risk*. Some participants disagreed, but there was agreement that budget support is more easily associated than other aid modalities with cases of corruption and fraud in a partner country. So donors themselves run a higher *reputational risk*. This is largely because donors are seen to support a particular government and all of a government’s policies once they provide budget support.

It is not helpful to talk about ‘safeguards’ against risks since it implies that all risks can be avoided, whilst in reality they cannot. Also, there is a belief that we cannot know what budget support is used for. This belief is contested. There are possibilities to observe how partner country spending has changed over time after budget support has been received. Also, nearly all budget support involves discussions between donors and the recipient government about the budget, so it is possible to anticipate on the relative riskiness of budget support. The risks also depend on what it is that budget support is supposed to finance. In Sierra Leone after the war, budget support was used to finance the pay-roll of civil servants. Given the strong demand from civil servants to be paid, there was less risk for major abuses or corruption. If the money would have been spent on a large contract to build a port, then the risk may have been much higher. In such a case, project support may make more sense. So it may be possible to assess the risks based on the likely spending.

According to the Court of Auditors, the EC’s *dynamic approach*<sup>11</sup> carries more risks than adopting an approach of *minimal standards*. It also points to the EC’s preference for medium to long-term outputs rather

<sup>11</sup> The EC applies the eligibility criteria for budget support in a *dynamic* way, meaning that it does not demand evidence of compliance with minimum standards, but rather requires partners to demonstrate credible commitment to reforms and progress.

than to short-term remedial actions. If minimum standards had been applied to countries such as Mozambique, budget support probably would not have been provided to that country. And Mozambique is no exception.

Furthermore, the costs of managing risks ought to be weighed against the benefits of engaging with partner countries on strengthening domestic accountability systems as well as with the higher transaction costs that are associated with project support. Budget support is more cost-effective than other forms of providing aid, so therefore the additional risks have to be assessed against the likelihood of more effective and efficient delivery of aid. One participant pointed to the need for donors to be more courageous to their constituencies when they communicate about risks and how to deliver aid more effectively. Donors should also avoid managing risks separately; what matters is how the EC and other donors behave collectively. One expert mentioned the possibility to outsource the assessment of risks to an external agency and thus reduce the reputational risk for the EC and other donors.

## 6. Budget support in situations of fragility

Budget support in fragile situations may contribute to stabilisation at economic and political levels. Budget support in such a context demands particular attention and management, and poses particular risks. But when doing a cost and risk calculation, one also has to assess the risks and costs of non-intervention, since these may be considerably higher. In November 2009 the EC made its procedures on budget support more flexible to accommodate for budget support in fragile situations. A *common approach* on providing budget support in fragile situations has been developed between the EC and the African Development Bank and the World Bank. Questions include:

- *Is a specific instrument needed for fragile countries?*
- *Should budget support be provided to all fragile states?*
- *Is this a special case for “minimum standards”?*

It seems that budget support in post-conflict states – and not necessarily in all *situations of fragility* – can be a powerful tool to restore key budget functions of the government. Even the US – usually reluctant to provide budget support – in practice provides it in post-conflict countries. In such contexts, the concept of ‘good enough governance’ is particularly relevant. While it was stressed that eligibility criteria have to be applied in flexible ways, some participants emphasised the need for a minimum capacity with government to plan and – more importantly – to execute a budget. An ODI conference on public financial management reforms and fragility<sup>12</sup> had emphasised the need to prioritise the capacity of the state to execute and monitor the budget.

One particular risk associated with budget support in fragile environments is that such support may discredit budget support as an aid modality. This argues in favour of using a different name for budget support in a fragile situation, the more so since the objectives of this budget support differ somewhat from budget support in more stable environments. In such fragile environments, the emphasis is likely to be on political stabilisation and to contribute to restoring the basic functions of the state. There was also caution against the notion of linking ‘lower risks’ to increased volumes of budget support.

<sup>12</sup> ODI conference, November 2010. [Accelerating the transition out of fragility – the role of finance and public financial management reform.](#)

## 7. Growth, fiscal policy and mobilisation of domestic revenues

Budget support focuses strongly on social sectors. Therefore, the Green Paper widens the horizon and incorporates the dimension of domestic resource mobilisation. This dimension is important for macro-economic stability and economic growth. The EC *Communication on Cooperation with Developing Countries in Tax Matters* stresses the need to support domestic resource mobilisation as part of the aid package of budget support, for example through the policy dialogue with partner governments on fiscal policies.

- *How can policy dialogue and conditionality in the context of budget support promote more domestic resource mobilisation and end aid dependency over time?*

Budget support does not have to be exclusively associated with support to social sectors. Some also point to its potential to contribute to economic growth over time (for example through funding the social sectors). It is unrealistic to expect that budget support will end the dependency on aid. But it is realistic to expect that it can contribute to promoting improved domestic resource mobilisation. In fact, there is a lower propensity to reinforce resource mobilisation through project support, while there is evidence of a positive correlation between budget support and domestic resource mobilisation. This correlation may be partly explained through the link between taxation and public finance management reforms, which is one component of the eligibility criteria for budget support.

It is important in this context to stress the need for transparency both on the donors' side and on the side of the partner country government. Transparency can contribute to strengthening domestic accountability on issues such as taxation policy. It was proposed to make tax exemptions public. Moreover, *“preventing tax exemptions for aid would be a very powerful way to positively contribute to address this issue”*.

But there is also an international dimension to taxation and development. The need was highlighted to promote transparency in global economic governance or international economic relations. The EC support to the *Extractive Industries Transparency Initiative* was highlighted as an encouraging example, as well as the EC's efforts within the *OECD Informal Task Force on Tax and Development*.

## Concluding remarks

This lively consultation between the EC and experts from academia, think tanks and NGOs about the past and the present of budget support showed that there is a future for this aid modality, and that – as one EC expert put it – *“we don't have to be defensive about budget support; there are sufficient positives”*. There are difficulties with measuring the effects of budget support, but this highlights two necessities. First, the need to demonstrate what has – or has not – worked in budget support and why. Numerous relevant diagnostics have been or are being produced (evaluations, case studies, practice oriented monitoring and other reports from the field, etc.) and merit to be shared, discussed, and used more vigorously to question and test some of the assumptions underlying the choice of aid strategies, instruments and approaches. Secondly, it also stresses the need to further document and research the complex relations between budget support (and other aid modalities) and development outcomes.

Yet, there are not enough opportunities for independent experts and researchers to exchange views, findings and evidence on budget support with (policy) practitioners. At a time that donors are being pressurised to demonstrate results and value for (aid) money, this lack of 'meeting space' is a gap. At the consultation, the Overseas Development Institute announced that it will enable such meetings on budget support to compare notes, gather evidence and set out research and other agendas (further information, [h.tavakoli@odi.org](mailto:h.tavakoli@odi.org)).

### Selection of contributions to the EC Consultation on the Future of Budget Support to Third Countries

Action Aid:

[ActionAid Position: Budget Support](#)

APRODEV (CONCORD):

[EC Consultation on the Green Paper on the Future of EU Budget Support to third countries. Contribution from the CONCORD HIV/AIDS Working Group](#)

DSW (Action for Global Health);

[Response to European Commission. Consultation on Budget Support, 11/2010](#)

EURODAD:

[Eurodad submission to the consultation on the "Green Paper on the Future of EU Budget Support to third countries"](#)

ODI:

[ODI's Response to the EC Green Paper on the Future of EU Budget Support to Third Countries, January 2011](#)

11.11.11 (EUROSTEP):

[Submission for input into the On-line consultation to the European Commission Green Paper: "The future of EU budget support to third countries"](#)

Belgium:

[Belgian comments on Commission's Green Paper on Budget Support](#)

Dr Rachel Hayman, University of Edinburgh (*individual contribution*):

[A commentary on the European Commission Green Paper 'The future of EU budget support to third countries'](#)

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- |                      |  |
|----------------------|--|
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| • Andrew Lawson      | FISCUS                                 |
| • Stefan Leiderer    | DIE – GDI                              |
| • Stephen Lister     | Mokoro                                 |
| • Nadia Molenaers    | IOB University of Antwerp              |
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| • Lonne Poissonnier  | 11.11.11                               |
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