

Budget support: experiences, results and lessons

- 1 The relatively new instrument of general budget support has been propagated more widely in recent times as a means of helping to improve development cooperation, to achieve more lasting development successes in partner countries and to make more effective use of the funds provided by our countries' taxpayers.
- 2 Like all instruments of development cooperation, budget support is designed to contribute to the realisation of the general goals of development policy, in other words combating poverty, establishing democracy, human rights and the rule of law, protecting the environment, peace-keeping and shaping globalisation in an equitable manner, while taking due account of international agreements and undertakings, such as the Millennium Declaration and its Development Goals or the Paris Declaration and the agenda adopted in Accra by the Third High-Level Forum on Aid Effectiveness.
- 3 General budget support is one of several instruments of development cooperation, and its application depends on the national context in the partner country, on basic conditions in that country and on the strategies pursued. Budget support is no panacea for all development problems, but in certain circumstances it is an important component of cooperation; it should be used selectively and carefully and be kept under constant review to ensure that it is serving its purpose. To our knowledge, this is done in all countries during the twice-yearly joint budget-support reviews by the providers of budget support and their partner countries on the basis of predetermined criteria. This mechanism also provides for responses to adequate or inadequate performance in pursuit of development goals.
- 4 Budget, project and programme support are not mutually exclusive instruments of development cooperation; in fact, they complement each other. It is a matter of finding the right mix for each specific country.
- 5 Budget support is seen as one instrument among many but one which is eminently suitable as a means of applying the principles proclaimed in the Paris Declaration, namely ownership, alignment, harmonisation, managing for results and mutual accountability. General budget support can serve to enhance the effectiveness of development cooperation if partner countries' policies are developed in dialogue with donors, if resources are concentrated on national and local priorities, if the appropriate players are involved and if donors' practices are harmonised.

More and more partner countries are asking for budget support. At the same time, reference has also been made to the fact that some partner countries have a rather diffident attitude to the dialogue that forms part of this instrument, although there is an observable increase in interest among the real target group of countries.

- 6 One moot point is whether a conflict exists between the Paris principles of ownership and alignment on the one hand and intensive dialogue on the content of national policies on the other. In this context it has become clear that it takes intensive political dialogue in the budget-support framework to uncover differences in priorities and that suitable forms of linkage (see Target 12 of the Millennium Development Goals) can be used to create incentives with a view to establishing at least some degree of convergence between the divergent interests of donors and partner governments.
- 7 Unlike balance-of-payments support and other forms of direct aid, general budget support is a longer-term instrument with a particular focus on fighting poverty and fostering economic growth. As is the case with other instruments, however, while a plausible case can be made for a direct causal link between budget support on the one hand and economic growth and advances in the fight against poverty on the other, it is difficult to furnish any evidence on the basis of current methodology.
- 8 Through the provision of resources that are neither ring-fenced nor repayable, general budget support constitutes an investment in the national development policy of partner countries. The national budget is the central instrument for the implementation of such a policy, which is why particular emphasis is placed on efficient management of public finances. As a rule, budget support is backed by accompanying technical cooperation in the form of harmonised consultancy assignments.
- 9 The Commission's motives for significantly broadening the use of the instrument include: (i) better alignment through the use of partner countries' own systems in the spirit of the Paris Declaration, (ii) intensive political dialogue in the budget-support framework, (iii) better coordination of donors through budget support, and (iv) the potential to exert a positive influence on internal accountability. The Commission refutes the frequent assertion that the instrument is designed to facilitate the flow of funds from the European Development Fund (EDF). On the contrary, the Commission reports that it is currently experiencing difficulties in some cases in obtaining the outgoing funds from the Member States.

The criteria formulated by the Commission for starting to provide a country with budget support were already laid down in the Cotonou Agreement. They include: (i) the existence of a clear anti-poverty strategy, (ii) stability-focused macroeconomic policies as assessed by the IMF, and (iii) a credible programme for the improvement of public-finance management.

The Commission has developed an evaluation mechanism for budget support, although that mechanism will first have to demonstrate that it works in practice. The use of budget support by the Commission is limited to the 79 ACP countries, and the 2004 Cotonou Agreement is the framework within which the instrument operates. Forty per cent of the new aid allocations in the tenth EDF, which amount to EUR 13 billion, are programmed as budget support, both general and sectoral, for 44 partner countries. This represents a considerable increase from the figure of 25% in the ninth EDF, the actual disbursement

figure during that funding period being 21%.

Budget support also plays a key role in the instrument of Millennium Development Goal (MDG) contracting, which features for the first time in the tenth EDF. In the framework of MDG contracting, reliable pledges of budget support are made for a six-year period, with a review after three years. In the tenth EDF, provision is made for MDG contracting with seven countries, all of which are in Africa. Budget support provided by the Commission is always accompanied by supplementary measures of technical cooperation.

- 10 The example of the budget support granted by Switzerland to Mozambique shows that financial and tax reforms and a huge increase in spending on education were largely due to the budget-support dialogue, which requires a considerable local commitment of human resources. Switzerland devotes about six per cent of its bilateral overseas development aid to budget support. The Netherlands and other donors base decisions to grant budget support on various criteria, such as good governance and commitment to the fight against poverty; at the present time, about a third of the Netherlands' bilateral overseas development aid is channelled into general and sectoral budget support. The recruitment of 6 400 additional teachers in Zambia is one of the tangible successes of this policy.

Budget support accounts for some eight per cent of German expenditure on bilateral cooperation. In the context of Germany's development cooperation with Rwanda and the budget support it grants to that country it was pointed out that rather favourable conditions now obtain in Rwanda; there are, for example, an independent national audit office and functioning tax authorities, although there are still considerable democratic deficits. It was stressed that efforts are undertaken to ensure that good governance is being practised in Rwanda, which relates not only to respect for human rights, etc., but also to budgetary transparency and the system of public procurement. The successes that have been identified are pursuit of the overarching development goals, including the consolidation of peace in the country, a greater degree of self-reliance, strengthening of the role of the budget as the main framework for government activity, promotion of a culture of democracy in Rwanda – reflected, for example, in the achievement of greater parliamentary involvement in, and scrutiny of, the national budget; moreover, the gains in terms of public accountability and transparency from overseas aid being part of the national budget were underlined. It also expressed the view that civil society can and must be even more fully involved in strategy deliberations.

- 11 Among the general advantages of budget support are that it fosters a dialogue between partners on a country's general policy and its policies in specific areas, a dialogue which can benefit from donors' experiences, that it enables donors' inputs to be dovetailed more effectively with the country's own efforts and that it allows certain issues to be addressed, such as neglect of rural areas or even the drive to acquire prestige symbols.

- 12 Unlike the former structural-adjustment programmes, budget support is based on a partnership; what distinguishes it most from the SAPs is that conditional linkages are defined by the partner countries on the basis of their own economic development and anti-poverty objectives. The conditions are

determined in a negotiation process instead of being set by the foreign donor. Political dialogue is now conducted continuously at a high level, and budget support has made it more intensive, wide-ranging and political. If donors have agreed locally on harmonisation and a division of labour and have appointed a lead donor for each sector, for instance, this increase in the donors' competence makes more demands of the partner country's ability to match their input. The instrument of budget support thus entails an increase in the power of donors, which they must exercise very sensitively and in the interests of both sides.

- 13 Budget support benefits partner countries by enabling them to commit resources to reforms and programmes; in place of frequently erratic pledges from donor countries, it gives them external funds that are more foreseeable, letting them plan ahead more confidently. It enables donors, especially if their efforts are better coordinated and harmonised and they are represented by competent individuals, to exert more influence on general policy and on policies in specific sectors, such as education or health, although this leverage should not be overestimated.

Budget support can play a valuable role in fostering a country's economic stability, encouraging private investments, ensuring that higher percentages of government expenditure are devoted to priority areas, such as health, education and infrastructure, making the allocation process more efficient, enhancing the efficiency of public-finance management and promoting better coordination of the efforts of donor countries.

- 14 There are also risks that need to be managed. Every financial transfer is vulnerable to corruption, particularly when large sums of money are involved. Budget support is no more or less open to corruption than project-based support. Nevertheless, the risk elements that are inherent in trusteeship are easily identifiable in the case of budget support. The moral hazard in the form of a temptation to respond to the inflow of foreign funds by relaxing efforts to mobilise internal resources through the national tax system must be taken seriously, although this scenario never seems to have materialised in any of the examples cited above. One final major risk lies in the process of political dialogue itself, if democratic institutions are few or non-existent and if dialogue is limited to the governments of donor and partner countries, being conducted without any input from democratic institutions such as parliaments, from local governments, from civil society or from the private sector. In a number of partner countries, national decision-makers are not primarily interested in improving the living conditions of the impoverished sections of the population. Such countries are unsuitable targets for budget support. This observation raised the question whether it is wise for the European Commission to be quite so quick in granting general budget support to many countries. The German Federal Ministry of Economic Cooperation and Development (BMZ) assesses eligibility for budget support on the basis of clear indicators of good governance, which have to be checked for each country. The practice of laying down target funding volumes for budget support in the annual financial framework is incompatible with this approach.

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- 15 All in all, the evaluations and practical experience so far reaffirm the belief that this kind of cooperation can bring benefits in many cases, but it is difficult to make a definitive pronouncement on the ultimate impact of budget support. The added value of this instrument and its place in the fabric of bilateral development cooperation must be subject to continual review.