

ODI's Response to the EC Green Paper on the Future of EU Budget Support to Third Countries

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ODI welcomes the European Commission's public consultation on the future of budget support. Given the growing interest in the results-based aid agenda, this consultation comes at an opportune time. In the current economic climate, tough decisions will be required about aid and it is likely that those decisions will be guided by performance. A better understanding of the complex relationship between aid modalities and their effects on outcomes is needed now to inform such decisions.

ODI has worked extensively on budget support across the world. The following are some of ODI's recent publications and resources on this issue:

- *Making sector budget support work for service delivery: wider policy implications (2010):*
<http://www.odi.org.uk/resources/details.asp?id=4737&title=sector-budget-support-policy-implications>
- *Aid effectiveness in Malawi: Options, appraisals and budget support (2010):*
<http://www.odi.org.uk/resources/details.asp?id=4729&title=aid-effectiveness-malawi-options-appraisals-budget-support>
- *General Budget Support and the MDGs (2010):*
<http://blogs.odi.org.uk/blogs/main/archive/2010/07/06/54017.aspx>
- *Sector Budget Support in Practice (2008):*
<http://www.odi.org.uk/work/projects/details.asp?id=1013&title=sector-budget-support#resources>

This submission is based on the opinions and experience of the following ODI researchers: Neil Bird, David Booth, Lidia Cabral, Pilar Domingo, Jonathan Glennie, Ed Hedger, Marcus Manuel, Greg Smith, Heidi Tavakoli and Tim Williamson.

In February, ODI will produce an 'evidence update' on Budget Support which will lay out more forensically the recent evidence on Budget Support and examine the relevant policy implications of such evidence.

* Disclaimer: The views presented in this paper are those of the Heidi Tavakoli (h.tavakoli@odi.org.uk) and selected colleagues and do not necessarily represent the views of ODI

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Political governance and the role of political dialogue

Q1. Should budget support operations (especially general budget support) be designed to better reflect partner countries' commitment to the underlying principles and if so, how? In particular, should budget support programmes make more use of political governance conditionality? Is there a case for adopting a different approach to political conditionality for general as opposed to sector budget support?

Designing Budget Support operations to better reflect partner countries' commitment to underlying principles is contested for two main reasons:

1. The European Commission (EC) (and other donors) should clarify the principle purpose of Budget Support against which its success should be measured. Budget Support serves many purposes and the objectives of its provision have changed over time. Rather than Budget Support operations accommodating additional objectives – that of the facilitation and enforcement of underlying principles – is it an appropriate time to take-stock, prioritise and clarify objectives? Following this process, if political governance is perceived to be a key objective of Budget Support, only then should it be incorporated in Budget Support operations. Prioritising the objectives of Budget Support will facilitate a more focused and effective policy dialogue and should essentially improve the effectiveness of Budget Support (as well as donors ability to measure the effectiveness), as support effort (including conditionalities) will be targeted to priority areas.

The EC should decide on a set of clear and prioritised objectives for Budget Support.

2. Second, the EC should reaffirm the essentials of its approach since 2000. It should guard from slipping further into political conditionality (and should reverse the slippage represented by the governance incentive tranche) since there is no evidence that governance conditionality is more effective than policy conditionality, and if anything the contrary (Molenaers et al, 2010a). Instead it should give more recognition to the fact that political dialogue and related Technical Assistance (TA) are skilled businesses for which donors need to be properly equipped (with both country knowledge and the ability to conduct a two-sided conversation, a real dialogue).

The EC should guard from slipping further into political conditionality given recent evidence contesting its effectiveness. Instead it should look towards strengthening the policy dialogue processes.

Q3. How can donors meaningfully respond to any deterioration in the underlying principles while protecting the development benefits and predictability of budget support?

Recent evidence suggests that the concept of governance is viewed quite differently by individual donors (Molenaers et al, 2010b). Therefore, in order to reap the benefits of donor coordination, an agreed set of principles, as well as examples of deviations from them, should be agreed in advance. If this is not achieved, donors' response to any deterioration in the underlying principles runs the risk of being uncoordinated and messy.

The EC should agree a set of common governance principles with other Budget Support donors, as well as examples of deviations from them.

Role of policy dialogue, role of conditionality and links to performance and Result

Q4. How can policy dialogue with partner countries be made more effective and inclusive in contributing to achieving reforms, results and objectives?

ODI's research on Sector Budget Support has clear policy implications and recommendations for making policy dialogue more effective. This recommendation is based on the premise that Sector Budget Support in many African countries has failed to address the 'missing middle' of service delivery; the capacities and systems needed for managing, supporting and supervising frontline service-providers. It points to the need to shift the non-financial inputs of Sector Budget Support, including dialogue, to the most problematic downstream questions related to service delivery. This can be achieved by investigating what these problems are and making an inventory of them. Following this, attention should be given to front-line human resource issues; the management and supervision of front-line delivery; and the hard facts about accountability to service users. To support this process, staff – both donor and recipient country officials – involved in policy dialogue need to be better informed of the downstream bottlenecks of service delivery and have sufficient time to discuss the issues and act on them. ODI's research suggests that a growing lack of sector-specific expertise and shallow country knowledge has given donors limited capacity to engage in dialogue on downstream service delivery issues effectively. Whilst, recipient country officials involved in the dialogue process often have planning or sector economics backgrounds, in practice they have limited interaction with front-line service providers and little experience in the management of people and organisations at that level (Williamson et al, 2010a; Williamson et al, 2010b; Williamson et al, 2010c).

In Sector Budget Support operations, the EC should attempt to address the 'missing middle' of service delivery by shifting the focus of policy dialogue to the most problematic downstream areas. This can be achieved by carrying out an inventory of such problems and strengthening the capacity of those involved in the policy dialogue to address them.

Q5. How should donors use budget support conditionality to help improve performance, and how should they respond to failure to meet agreed conditions?

The Green Paper is silent on the process of arriving at conditionalties in Budget Support operations. This discussion was also excluded from the recent PRSC evaluation. Attention should move away

from focusing on the symptoms of problems, e.g. what do we do when conditionalities have not been met, to trying to better address the causes of the problems, e.g. was there sufficient ownership/political buy-in of the conditionalities in the first place? Understanding more adequately the real incentives around performance and conditionalities may help explain why some conditionalities are met whilst others are not. Such analysis should then not only inform the selection of indicators for PAFs, and the associated conditionalities tied to them, but also ways to tackle the real incentive problems that are undermining improvements in performance.

The EC should try to improve its understanding of the political economy of Budget Support operations and incorporate such knowledge into future operations.

The results-based variable tranche was another slippage away from the initial recognition of the limited effectiveness of conditionality, based on the spurious argument that only policy conditionality had been shown to be ineffective. Before embarking on a further period of trying to incentivise change by modulating disbursements, or adopting any variant of Cash on Delivery aid, EC should commission a serious evaluation of the experience with the results-based tranches.

Before expanding the MDG contracts the EC should carry out an evaluation of its effectiveness.

Q6. How can performance monitoring frameworks (PAFs) be improved and result indicators be best used in budget support operations in order to address the challenges identified above?

ODI research warns against the ballooning of country PAFs. PAFs often expand as actors change and new priorities are requested to be absorbed. PAFs and the associated indicators should remain streamlined, with only key indicators prioritised. The necessity to reflect only priority indicators in PAFs was highlighted by ODI research which showed that indicators in PAFs are often a poor representation of key policy changes and reforms. The potential of PAFs as instruments to monitor performance and to stimulate improved policy performance in strategic areas is therefore rather limited.

PAFs should remain streamlined and focused on key policy changes.

Q7. How can the performance of the public financial management system, including fraud prevention measures, and the value for money of budget support funds be best enhanced? Should the EU set minimum requirements for budget support?

The EC (and other donors) need to be stronger on value for money (VfM); what does it mean for Budget Support and how will this be achieved. Implementing some of the suggestions in this note should go some way to improving the VfM of Budget Support, but a clear VfM framework should be set out. In addition, the EC (and other donors) need to be stronger on the pace of PFM reform expected as well as the additional safeguards necessary for Budget Support operations. That said,

the EC should guard against introducing a set of minimum requirements for Budget Support as this is likely to restrict Budget Support operations in fragile states and environments.

The EC needs to be stronger on VfM and on the pace of PFM reform expected as well as the additional safeguards necessary for Budget Support operations. Yet the EC should guard against introducing a set of minimum requirements for Budget Support.

Accountability

Q8. How can budget support (including capacity building) be designed to further enhance domestic accountability and ownership in partner countries, including the participation of civil society?

This again raises the question of the skill mix and human resource availability in the donor offices. Too much of the discussion about enhancing domestic accountability reflects an assumption that the institutions of poor countries work in essentially the same ways as those of OECD member states, but just do their jobs less well. This aspect of the dialogue component of Budget Support packages needs to be managed by people who understand the distinctive strengths and weaknesses of the institutions of particular countries, and thus where are the entry points for building domestic accountabilities that have a real prospect of working and – no less important – for mitigating the institutional harm done by large aid inflows.

Budget support should be aligned with the country political system mechanisms of policy deliberation and decision making. This includes necessarily engaging with legislatures and MPs to ensure their voice in decision about Budget Support, in line with country regulations for legislative input and oversight on budgetary issues. In addition civil society should also be part of the consultation processes – but equally these should be aligned with the political system rules of decision making on budgetary processes.

EC officials managing Budget Support packages need to be sufficiently informed of appropriate ways to build domestic accountabilities. Budget support should be aligned with the country political system mechanisms of policy deliberation and decision making.

Programming of budget support and its coherence with other instruments

Q11 & Q13. What criteria should the Commission use to inform decisions on how much if any, budget support to provide to eligible countries?

What are the advantages and disadvantages, as well as the practical arrangements to ensure consistency and efficient coordination, of using a broad palette of aid instruments alongside GBS/SBS?

In recent years there has been an increase in the variety of aid modalities. As the Green Paper notes, these aid modalities co-exist with Budget Support. One useful way to address the Green

Paper's question about the optimal level of General Budget Support and Sector Budget Support would be to think about how to develop an optimal portfolio of instruments overall. Such a portfolio, either at the aggregate or sector level, would be designed and managed in a way that maximises the complementarity of aid modalities at the country level. The portfolio would include both Budget Support and other aid instruments, as Budget Support rarely exists in a vacuum in recipient countries. In order to achieve this, actors would initially agree on an ultimate objective e.g. better service delivery. Following this, they would explore how best to facilitate this objective and then what instruments would be best suited to achieve it. Such an assessment would be based on practical experience rather than a more abstract debate of the net benefits of each instrument. The characteristics of the instruments should address the factors that create the key bottlenecks in service delivery e.g. predictability, and the results should focus on getting the systems and institutions to work, not solely the performance indicators. In terms of assessment processes, this would mean that assessment and appraisals would move from analysing the net benefits of different aid modalities (Options Appraisals) to the net benefits of different portfolios.

The EC should starting thinking about designing optimal portfolios of instruments, designed and managed to maximise the complementarity of aid modalities at the country level.

In addition to this, the decision on the most suitable modality mix should be based on the country's own strategy on aid finance, rather than a theoretical discussion on the pros and cons of different modalities. Where such strategy is not clearly spelt out (i.e. in most developing countries), the first step should be to support governments to develop it. Some key elements of such strategy are identified in the Green Paper: financing needs, absorptive capacity, and suitability of different modalities to the particular context. Alongside these factors the sustainability and comparative advantages of different donors, some of which are tied to particular forms of aid provision, should be accommodated. The important point to make is that such analysis only makes sense in relation to the totality of aid and if it has the interests of the recipient (policy-related and political) at its core.

The most suitable modality mix should be based on the country's own strategy on aid finance.

It is worth noting that the broad palette approach is preferred by donors for risk avoidance, but for countries use of projects alongside Sector Budget Support in service-delivery sectors can undermine the benefits from the use of Budget Support. This should be distinguished from just projectising parts of the Budget Support package for specific operational reasons. This should be taken into account when designing the portfolio.

Budget support in situations of fragility

Q17. Should budget support be used to promote stability in fragile states, and if so, how?

Historically, Budget Support has been provided in fragile states and in countries such as Sierra Leone and Mozambique it has been fundamental to supporting economic conditions and

facilitating sustained peace. This is one of the reasons why Budget Support should continue to be provided in such environments. To-date there has been limited analysis of Budget Support and fragile contexts, beyond individual country case studies. Therefore the upcoming research on Budget Support and policy based lending in fragile states carried out by Oxfam and AfDB should help guide future EC policy choices. This should help explain if, and how, Budget Support has been used to promote stability in fragile states. At this stage, any movement away from EC 'eligibility criteria' and towards setting 'minimum standards' should be taken with care, as this will have considerable implications for EC Budget Support provision in fragile states.

At the ODI conference 'Accelerating the transition out of fragility: The role of finance and public financial management reform' government officials from a selected number of fragile states made clear their demand for this aid modality. However, performance and fiduciary risks suggest that innovative approaches for its delivery should be sought. Such innovative approaches need to take into account answers to the following questions: What should the role of budget support be in fragile states and should it be different from its provision in fragile states? What are the roles of other aid instruments which share some similar principles to Budget Support; what are their similarities and main benefits of each instrument? What is feasible to achieve in a fragile situation?

Forthcoming research findings on Budget Support and fragile states should guide the EC's policy in this area and the EC should consider funding further research on this topic.

Areas not sufficiently covered in the EC Green Paper

In addition to the areas discussed above, ODI researchers felt that the following areas were not sufficiently covered in the Green Paper. First, the Green Paper doesn't address the challenges that surround the shifting objectives of Budget Support. Second, it fails to touch on donor coordination and whether different donor perceptions of the purpose of Budget Support have affected the achievements of such operations. Third, there is limited discussion of the issues surrounding the innovative results-based approach by the EC, the MDG contract. Fourth, there is a lack of a commentary on predictability. Finally there is a lack of commentary on the influence of non-DAC donors. Given the growing significance of non-DAC donors, it would be useful to explore the implications of their engagement on the future of EC Budget Support. It is particularly pertinent for 'political governance and the role of political dialogue'.

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