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The rise of budget support in European development cooperation: a false panacea

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›› Several decades of large international aid flows to Africa have transferred an estimated 1 trillion US dollars to the region. Now, the global economic crisis has tightened the West's belts, drying up significant portions of the funds that had been pledged to developing countries. The latest figures show that European donors cannot sustain their aid policies during the recession. Against this unpropitious background, how can the European Union (EU) make its aid policies more effective?

Many policy makers believe they've found the answer in budget support. This is the new fashion sweeping the world of international development. Budget support has gained prominence as countries seek to address some of the failures of current aid policies to reduce poverty. Assessing the effectiveness of budget support is central to ascertaining whether the two-year old Africa-EU partnership is making progress in meeting core development aims. It is also vital ahead of the major review of the EU's Cotonou accords that will take place in 2010.

Budget support is aid funding to governments that is not earmarked to specific projects or expenditure items, thus moving away from the imposed conditionality of the structural adjustment era. It is disbursed through the government's own financial management system and is specifically intended to support countries' poverty reduction strategies.

The rationale behind budget support is relatively straightforward – increase aid effectiveness by fostering country ownership and domestic accountability with the ultimate goal of poverty reduction. But European donors are rushing headlong into uncharted territory, delivering surging amounts of aid through this new instrument.

HIGHLIGHTS

- European aid donors are taking important steps to meet their promises to deliver a higher share of development aid directly to governments in the form of budget support;
- While budget support offers positive potential for enhancing local accountability within developing states the way it is being implemented is having a negative impact;
- More nuanced political analysis is required to ensure that budget support enhances rather than undermines democratic accountability in developing countries.

The Paris Declaration on Aid Effectiveness (2005), the European Consensus on Development (2006) and the ACCRA Agenda for Action (2008) have clearly driven the shift towards budget support by enjoining donors to channel aid through recipient country systems. But already the success of the initiatives is debatable. It is still early days, but recent evaluations show that budget support's potential to alleviate poverty may be over-stated. In many African countries, especially least developed countries (LDCs), it may do more harm than good by subsidising and reinforcing bad governance.

Unfortunately, budget support has already attracted unwelcome attention as questions over its impartial applicability have arisen. If budget support's potential for reducing poverty and fostering country ownership and accountability is limited, could there be other motivations behind donors' eagerness to adopt budget support?

This raises important and difficult questions about budget support's *raison d'être*. The complex set of donors' and country elites' motivations and constraints becomes crucial to understanding why the goal of poverty reduction may not be prioritised and thus not achieved.

A NEW PANACEA

The international development community is united to a great extent in its conviction that aid must be reinvented if Africa is to be lifted out of its persistent poverty and stagnation. The last ten years have seen a surge in budget support operations informed by a new aid philosophy which emphasises flexible funding and country-led poverty reduction efforts.

For the World Bank, budget support accounted for 13 per cent of all International Development Association lending in 2001. By 2004, that share had risen to 43 per cent and by 2005 to 50 per cent. The European Commission and the UK's Department for International Development (DfID) have pumped up budget support to around 50 per cent of their total aid. This rapid increase in the use of budget support is based on the assumption that a combination of 'getting the macro policy right' and 'partnership' will result in faster development and poverty reduction than project-based lending.

The main theoretical tenets in favour of budget support compared to traditional modes of aid delivery are numerous. But, as with most aid initiatives, to work effectively it relies on a sound institutional and policy framework. With these in place, budget support promises a more effective scaling up of funds aimed at poverty reduction. It also offers scope for providing funds in a more predictable and sustainable manner, coordinating external financing with the country's budget cycle, addressing cross-cutting issues and constraints on development, ensuring a more efficient use of resources, and enhancing institutional capacity.

But there is a more self-serving, alluring reason for donors to turn to budget support. It enables the donor to increase aid delivery, thus meeting disbursement rates, without requiring an enlargement of their own administrative operations, thus keeping costs down. This motivation has more to do with donors' institutional dynamics than with poverty reduction.

The transfer of funds directly into a government's budget poses macroeconomic, institutional and political risks that its proponents have not adequately addressed. The argument for budget support rests on a distorted reality where the stated goals of country ownership, domestic accountability and poverty alleviation conflict with both donors' institutional imperatives and recipient countries elites' interests and constraints. This complex set of incentives may even undermine the very goals that they intend to support.

COUNTRY OWNERSHIP

The provision of budget support is a logical response to demands by African leaders for partnership and local ownership. Budget support can encourage ownership by increasing the overall share of funds that are included in a national budget process, using a country's own system. In addition, it is argued that donors and recipient governments can further strengthen ownership by focusing on national development choices, rather than donor priorities. This, the logic runs, can encourage a broad national debate, ensure that the programme of policy actions is endorsed by a broad spectrum of stakeholders, and align conditionality to reflect development priorities identified in the Poverty Reduction Strategy Paper (PRSP) and medium-term expenditure framework.

Such positive dynamics may take root in recipient countries with adequate institutional frameworks to implement reform programmes and account for the use of resources. But most African countries are far from having the requisite institutional framework. Budget support candidate countries tend to be characterised by capacity and institutional constraints, with poorly managed administrations that are weak and susceptible to outside influence. This weakness provides an entry point for external influences in return for direct funds to their administration. When this is the case, genuine ownership of the policy making process is an illusion. Instead, there has been a gradual increase in the prevalence of donors' imperatives in the recipient countries' policymaking, actually undermining the rationale of partnership and genuine country ownership.

Political risk analysis should be systematically carried out before any budget support operation

In fact, instead of encouraging greater country ownership, the relationship between governments and donors, especially the World Bank and the European Commission, has moved towards a 'post-conditionality approach' where paradoxically donors are much more closely involved in the policymaking. We see this in the support they give to administrative reforms in central ministries and in the arrangements related to the disbursement operations of budget support. Recent research done by Eurodad suggests that, while budget support increases the sense of ownership, it often comes at the cost of greater intrusion and influence of donors in all aspects of national budgets. Beyond the rhetoric of partnership and trust, donors exercise a tighter grip on the policy making of the recipient countries than before.

This brings about mutual dependence between donors and state elites. Governments that depend on high levels of donor funding do their best to comply, at least formally, with the reform agenda being promoted by donors, and donors get to use these countries as 'success stories' in international arenas. All this, however, takes place at the expense of a genuine poverty reduction reform agenda.

DOMESTIC ACCOUNTABILITY

Budget support is said to reinforce locally-oriented accountability and potentially strengthen governments' capacity to design and implement programmes. However, in the absence of strong political mechanisms to ensure that African countries will be accountable to their own peoples, large aid flows that go directly to the recipient country's coffers could widen the gulf between state and society. When donors provide between one-third and one-half of a country's annual budget, and do so with few preconditions, there is little incentive for recipient governments to develop other revenue sources. They thus actually become more aid dependent and less accountable to their people. Worse still, by financing incumbent governments, donors may be preventing healthy domestic accountability mechanisms from developing, potentially propping up anti-development regimes.

Most political parties in Africa mobilise the electorate on an ethnoregional basis. This relies on large amounts of patronage in the form of jobs and cash. These are in short supply, which is why budget support is so appreciated by government leaders. Because money is fungible, budget support is a significant provider of political finance. The diversion of large amounts

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of funds into unaudited accounts, or to accounts for which audits are not disclosed to the public, enables a portion of budget support to be used to maintain patronage machines. Fungibility means that aid can become hostage to the local context. For instance, the first evaluation of budget support in Tanzania noted that there is little evidence of parliament's scrutiny of public finances improving significantly since the expansion of discretionary funding.

Increasing the flow of aid without developing ways to improve probity, transparency and accountability can reinforce dysfunctional systems. This is particularly true in aid-dependent countries, where donors can damage domestic accountability if they become the main audience to which governments respond. It isn't only the governments that are to blame. Donors themselves demand little accountability from governments, which can only encourage corruption by the recipient countries.

The fact that aid is channelled directly to governments' budgets and thus delinked from specific projects where results can be measured, means that donors' accountability erodes away as no official or donor agency can be held accountable for poor outcomes in the recipient country.

Paul Collier has argued that governments that depend largely on aid may lack a strong incentive to boost the prosperity of their population, whereas the opposite is true of governments that rely heavily on domestic tax revenues. Budget support can act as a substitute for tax revenues. Sub Saharan Africa, the largest budget support recipient, has undergone very limited net fiscal expansion and most resources either flow back out in the form of capital flight or are accumulated as reserves. The challenge for donors is to devise methods to encourage governments to account to their people. For instance, this could be done by supporting them in the reform of their fiscal systems so that revenue would be raised from taxes, therefore giving citizens the incentive to hold their governments accountable.

POLITICS MATTERS

Budget support is excessively centred on macroeconomic policy. While it is necessary to get the macroeconomics right it is insufficient for poverty alleviation as it leaves governance and political considerations off the radar. The need for genuine, and not mere electoral, democracy is crucial in alleviating poverty. The full potential of democracy, especially the promise of accountable governance, has yet to be fulfilled. Larry Diamond estimates that half of the forty-eight states of sub-Saharan African now meet the minimum requirements of representative democracy. However, more than half of these countries' key regulation and oversight institutions lack the legal and operational independence, the financial resources and the leadership to hold the executive branch of government meaningfully accountable.

Careful risk assessment and management is essential when delivering budget support. Yet, donors invariably forsake this. Staff feel pressure simply to disburse funds, which has long been the basis for successful careers at donor agencies. This is coupled with the fact that many agencies such as the World Bank cannot formally take politics into account, and others such as the European Commission rely too heavily on macroeconomic assessments made by the IMF. Often, this results in an irresponsible and poorly timed disbursal of money that doesn't result in the envisaged goal of poverty reduction.

A recent and particularly contentious example of this can be found in Kenya. Two days after the east African country's general election in 2007, which resulted in 700 people being killed and 250,000 being driven from their homes, the European Commission disbursed EUR 40 million through its budget support programme. The preceding months had been mired by political instability and social upheaval, but this was not taken into consideration. Shoving money out of the door does not transform underlying political realities, if anything, it exacerbates the use of funds for purposes other than poverty alleviation. Political risk analysis should be systematically carried out before any budget support operation.

The need to go beyond aid dependency to ensure a sustainable poverty reduction strategy is crucial. Recipient countries should be encouraged to revitalise their moribund or virtually nonexistent private sectors. This, together with a reform of the tax system can serve as a reliable source of government income to reduce poverty. Rwanda's president, Paul Kagame, argues that Africa's relationship with its international counterparts should be redefined: the emergence of a healthy private sector rather than large sums of money given directly to African governments is key to reduce poverty. So far this is not happening. Africa's share of global trade remains at around 1 per cent (having fallen from a high of 3 per cent sixty years ago), even though it is commodity-rich. Budget support could inadvertently suppress the emergence of just such a dynamic private sector.

While it is necessary for recipient countries to reform in a meaningful way it is equally important that aid agencies and donor governments change the way they deliver aid. Donors' effectiveness is still measured in terms of disbursement rates. Budget support amply serves that goal at the expense of a careful assessment of the political and social implications it may have. Many development agencies still fail to take the political dimension sufficiently into account.

Poverty reduction strategies should create the circumstances in which individuals can prosper. For this to happen, effective mechanisms must be in place to facilitate the transfer of capital and services to the neediest, making governments aid independent and accountable to their citizens rather than to donors. On paper, budget support could have the potential to reduce poverty along just these lines. But, for that to happen, donors and recipient country elites' motivations would have to change dramatically. Currently, that seems unlikely to happen. Ultimately one should remember that not a single country on the African continent has become prosperous or stable through aid alone. To date, budget support has been fashioned to be influential rather than effective.

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