

Insights from recent evidence on some critical issues for Budget Support design

By Heidi Tavakoli and Gregory Smith

This Background Note explores recent evidence on Budget Support to understand how such support has performed over time against its original rationale and expectations. While acknowledging the lack of consensus around the precise rationale, expectations and objectives for Budget Support, we have, for the purposes of discussion, assumed that the original rationale equates to the benefits laid out in the 2002 General Budget Support evaluability study by the UK Department for International Development (DFID).

We analyse the evidence for each of the expected benefits in turn, finding that performance has improved over time in a number of areas (particularly transaction costs and increased effectiveness of partner country public financial management systems). Limited evidence, however, and the complexity of measuring progress on some of the benefits, has resulted in an inconclusive picture.

The Background Note outlines the original rationale and expectations, and the shifts in the aid architecture that led to the rise of the ‘new’ form of Budget Support. We then test the expected benefits in turn, using an assumed rationale. In doing so, we ask how well Budget Support has fared, given its original rationale, and explore design issues. Finally, we suggest ways in which Budget Support could be re-designed to achieve its original rationale.

Original rationale and expectations for Budget Support

The trends in the international aid architecture leading to the demand and implementation of what became known as the ‘new’ form of Budget Support have been well documented (Koeberle et al., 2006; Lawson et

al., 2002).¹ Koeberle et al. (2006) point to eight key trends that explain the emergence of, and increased emphasis on, Budget Support over the last decade:

- the shift away from traditional project support
- the shift from ex-ante conditionality to partnership-led approach
- greater emphasis on country ownership, systems and capacity
- shift from short-term to medium-term reforms
- recognition of the disruptive role of volatile and unpredictable aid
- greater selectivity in favour of good performers
- enhanced focus on results
- scaling up of aid.

These trends, especially the earlier ones, predominantly stem from the dissatisfaction with the negative institutional effects of the previous dominant aid modalities.

This is reflected in one of the first pieces of research to test the theoretical claims of the advantages of General Budget Support – DFID’s evaluability study, carried out by Lawson et al. in 2002. First, the study explicitly compares the benefits of Budget Support to the weakness of the then predominant aid modalities. Second, it focuses on the institutional effects of the new type of aid, assuming that ‘improvements in these areas would be highly likely to enhance a Government’s capacity to reduce poverty’ (Lawson et al., 2002). Therefore, at the time of the shift to the ‘new’ Budget Support, its main benefits were seen as its ‘medium-term institutional effects’.

Since 2002, expectations of the benefits of Budget Support and frameworks for its analysis have evolved. Koeberle (2006) adds two benefit streams to those outlined in the evaluability study: ‘strengthened country ownership and ensuring the sustainability of reforms’ and ‘ensuring a greater orientation to medium-term results’.

The Overseas Development Institute is the UK’s leading independent think tank on international development and humanitarian issues. ODI Background Notes provide a summary or snapshot of an issue or of an area of ODI work in progress. This and other Background Notes are available at www.odi.org.uk.

This Background Note was financed by the European Commission. The views expressed in this paper are those of the authors and do not necessarily reflect those of the European Commission.

Box 1: Problems with project aid highlighted by aid evaluations in the 1980s and 1990s

- The transaction costs of delivering aid through projects became unacceptably high for countries with large numbers of aid projects and a multitude of donors, each with their own reporting schedules and accounting requirements.
- Donors could force their priorities upon governments and tie procurement to their own country contractors, leading to inefficient spending.
- Problems in meeting the disbursement conditions and implementation requirements of different projects led to great unpredictability in funding levels.
- The effectiveness of government systems was seriously undermined by extensive reliance on parallel, non-government project management structures and special staffing arrangements.
- Accountability became skewed towards donor-specific mechanisms of accountability, corroding the normal structures of democratic accountability.

Source: from Lawson et al. (2002).

The evaluation frameworks to measure the effects of Budget Support have become more sophisticated, re-categorising the results of the intervention framework and laying out the causal chains through which the institutional effects impact on poverty reduction and growth, accounting for other contextual factors. These frameworks, therefore, attempt to address the ultimate objectives of Budget Support: those related to its impact.

One explanation for this shift is the diversity of donors' views, as well as those of researchers, on the rationale, definition and objectives of Budget Support (Nilsson, 2004). Nilsson, for example, sets out the different donor definitions of Budget Support. This implies that donors have varying views of what Budget Support should look like as well as what it should achieve. This diversity is also reflected in analytical research, which, according to Nilsson's paper, shows that publications outline different objectives and rationales for the 'new' Budget Support. These differences can be seen in the literature to this day.

These continued differences in donor objectives were highlighted by a recent European Court of Auditors report on General Budget Support, which noted that 'The Commission's use of standardised objectives for its General Budget Support programmes means that it is difficult to adjust the programmes to coordinate them with other donors' objectives for their General Budget Support programmes' (ECA, 2010). These differences may explain different emphasis on the Budget Support 'package' by donors, a different analytical focus of its performance, and different expectations of its success.

While there may be consensus on the trends that have led to greater emphasis on Budget Support over the last decade, no consensus around a precise rationale, expectations and objectives, across development practitioners or over time, has materialised. This conclusion is not novel, as there has been commentary on poorly defined objectives for Budget Support for some time (Lawson et al., 2005; NAO, 2008). However, it has two important implications. First, there is no commonly-held, all-inclusive, donor-supported rationale for Budget Support from which its current performance can be assessed. Second, differences in donor expectations of Budget Support, if reflected in their approach, are likely to affect its design and implementation.

Pertinent design issues

Assessing the performance of Budget Support against its original rationale and expectations is not straightforward. To address this challenge, we revert to one of the first evaluative frameworks of the 'new' Budget Support to test the theoretical claims of its advantages – DFID's 2002 evaluability study. This study describes the expected benefits of General Budget Support, including:

- reduced transaction costs
- higher allocative efficiency of public expenditures
- greater predictability of aid flows
- positive transformational effect on government systems
- a more benign effect on domestic accountability (Lawson et al., 2002; Naschold et al., 2002).

Adding more recent evidence, we test the benefits in turn to determine whether Budget Support has realised these advantages and whether changes in practices have improved or undermined its ability to achieve its objectives.

There are two caveats. First, we examine only the institutional effects of Budget Support. Other effects, such as the policy effects and the causal relationships between the institutional effects and poverty and growth are not covered. In addition, the evaluability study is about the benefits of General Budget Support and as such may not be the most appropriate way to assess Budget Support more broadly (including Sector Budget Support). However, the benefits of General Budget Support should also apply to Sector Budget Support, albeit at a different level e.g. allocative spending improvements at the aggregate or sector level.

It is also worth noting that there are few papers in the aid effectiveness literature that examine or test Budget Support theoretically or empirically, and fewer still that compare it directly with other aid modalities.

Analysis of the effects of Budget Support to date has relied primarily on in-depth case studies to establish its performance. Such research has focused on how well it creates an ‘enabling environment’ for policy reform and improved public-sector management, rather than its overarching objectives of poverty reduction and economic growth.

Assessing Budget Support in terms of its direct impact on such results is extremely difficult, given the long and fragile nature of the causality chain, and this explains the limited research in this area. One exception is Beynon et al. (2010) who analyse its impact on performance against the Millennium Development Goals (MDGs), comparing results in countries receiving ‘high’ or ‘low’ levels of Budget Support. They find that ‘high’ Budget Support recipients have improved performance, although results are based on correlations and the direction of the relationship cannot be confirmed.

Cross-country regressions have also been used to measure the impact of Budget Support on economic growth. But both case study analysis and cross-country regression methods have suffered from a high level of aggregation. Trying to address this, statistical impact assessments, which measure the impact of Budget Support (through its policies) on a representative sample of the target group, are gaining ground following Gunning et al.’s 2007 paper on education in Zambia. However, beyond concerns about using randomised control groups in development economics, a more practical limitation of statistical impact analysis is the lack of reliable data. Even so, this type of research is likely to increase (the European Commission is expected to work in this area in 2011).

The poor availability of data has historically imposed a strict limit on empirical testing of Budget Support and is one of the key difficulties of separating the effects from other aid modalities. This forces the analysis in this Background Note to focus on performance improvements over time rather than across modalities.

Reduced transaction costs

Budget Support is often cited as a way to reduce transaction costs as it reduces the need for separate project management or implementation planning and monitoring. This assumes that aid from multiple donors is harmonised, disbursed jointly and aligned to government systems. However experience and evidence show that costs are likely to be reduced only over the medium term. This is because the initiation of Budget Support operations includes establishing new modes of interaction between governments and donors, as well as new skills for policy dialogue, which increase transaction costs in the short run (Koeberle et al., 2006). By 2004, some donors were expecting these increased short-term transaction costs (NAO, 2008).

Early analysis of the effects on transaction costs shows a rather negative picture. Killick (2004) argues that there is little evidence for reduced transaction costs in Budget Support operations. Frantz (2004) goes further, arguing that in Tanzania, ‘on the side of the Government, transaction costs have most clearly risen for the Ministry of Finance, whose capacity is being stretched by the de facto responsibilities it has for a number of reform programs throughout the Government’ (Frantz, 2004). In its evaluation of five country studies, USAID found that transaction costs can jump considerably, particularly during General Budget Support start-up periods (USAID, 2005 in Knoll, 2008).

Nevertheless, later studies found that transaction costs were reduced over the medium term under certain conditions (e.g. the exclusion of competing aid modalities) and as Budget Support operations evolved.

According to the 2006 Joint Evaluation of General Budget Support, ‘although the high-level negotiation and monitoring costs of Partnership General Budget Support (PGBS) are often perceived as onerous, there are large transaction cost savings for partner countries during the implementation of PGBS-financed activities. However, the extent of transaction cost savings has been limited by the scale on which other modalities have continued in parallel’ (IDD/OECD, 2006).

The evidence that transaction cost savings were undermined by the existence of other aid modalities was supported by more recent findings on Sector Budget Support, ‘where SBS has involved multiple donors, there was a sense that SBS has led to a relative reduction of transaction costs. If the same aid had been provided through separate projects, transaction costs would have been higher. The relative gains in transaction costs were drowned out when SBS was accompanied by large project flows, which was especially common in the health case studies’ (Williamson et al., 2010).

The evolution of Budget Support operations has reduced transaction costs. Cavalcanti (2007) illustrates how policy innovations helped reduce what he classifies as two of the three types of transaction costs in the Multi-Donor Budget Support operations in Ghana between 2003 and 2007. This was achieved by first, giving greater responsibility to sector-specific groups responsible for agreeing, monitoring and assessing performance against the Multi-donor Budget Support policy matrix, which decreased coordination costs. Second, rotating the donor leadership of the Multi-donor Budget Support helped address collective action problems (Cavalcanti, 2007).

Despite evidence of reduced transaction costs in certain circumstances, there are clear bottlenecks that blocked further achievements. These include: poor progress on the harmonisation and alignment of Budget Support operations (Nilsson, 2004; Knoll, 2008), the

weakening of dialogue as a result of the high turnover of donor staff, and slippage towards derogations from country systems (Williamson et al., 2010).

Better data on transaction costs is required. The complexity surrounding the definition and measurement of transaction costs means that few studies focus primarily on transaction costs, beyond those by Brown et al. (2000, in Koeberle, 2006) and Cavalcanti (2007). The NAO 2008 report on Budget Support criticised DFID for not collecting sufficient evidence to show that transaction cost reduction. It suggested that studies had failed to assess the impact of Budget Support on costs to donors and partner governments, pointing to weaknesses in the clarity of the definition of transaction costs (NAO, 2008).

Applying the concept of transaction costs to the Paris Declaration, Lawson (2009) attempts to clarify this definition, referencing the original literature. His persuasive argument explains why attempting to measure the exact transaction costs of aid or the Paris Declaration is an ultimately futile task. In its place he suggests that perceptions of transaction costs should be used as a proxy for net transaction costs per dollar of aid (Lawson, 2009).

Higher allocative efficiency of public expenditures

Naschold et al. (2002) outline the expectation that Budget Support should improve the allocation of public expenditures. It should shift dialogue to discussions about the aggregate allocation of resources, facilitate a process of getting aid ‘on budget’, encourage the prioritisation of poverty reduction policies and improve consistency between the recurrent and investment sides of the budget.

Assessing this is a complex task. Typically, improved allocative distribution of public expenditures means better alignment of resources with pro-poor/poverty reduction expenditures. Here, there is clear evidence that Budget Support has performed well (IDD/OECD, 2006; Lawson et al., 2007; World Bank, 2010).

According to the Joint Evaluations of 2006, it has facilitated increases in priority, ‘pro-poor’ expenditures in Poverty Reduction Strategy Papers (IDD/OECD, 2006). This finding was supported by the Ghana evaluation, which followed soon after (Lawson et al., 2007). The recent Poverty Reduction Strategy Credits (PRSCs) evaluation states that 92% of government counterparts interviewed agreed or strongly agreed that PRSCs helped to align public expenditures with priorities defined by the country’s medium-term development strategy (World Bank, 2010).

However, criticisms of the often broad and superficial definition of pro-poor expenditures remain (IDD/OECD, 2006). There are also practical challenges related to the policy orientation of the budget process and to budget fragmentation that can undermine

efforts to improve the allocative efficiency of public spending (Lawson et al., 2007).

Greater predictability of aid flows

Research highlights the detrimental effects of unpredictability of aid flows on economic growth, debt, sectoral allocations and service delivery (Hedger et al., 2010; Lensink et al., 2000; Knoll, 2008). The ‘new’ form of Budget Support was expected to improve predictability, as it would avoid the problems of fulfilling disbursement conditions and implementing requirements associated with project aid. Budget Support was expected to involve long-term commitments delivered in a limited number of instalments.

Evidence on the performance of ‘new’ Budget Support in this area was not promising in the first half of the 2000s. Knoll (2008) used Strategic Partnership for Africa (SPA) data from 2002-2005 on the African Budget Support recipient countries to illustrate that General Budget Support disbursement remained volatile at the country level over the entire period. Using Creditor Reporting System (CRS) data, she also showed that the gap between commitments and disbursements from 1995-2005 (covering both the ‘old’ and ‘new’ Budget Support) had widened in absolute terms, while narrowing in relative terms (Knoll, 2008).

Analysis at that time by the IDD/OECD Joint Evaluation (2006) also highlighted lack of predictability as a problem. In each of the Joint Evaluation countries, there were suspensions of programme aid, and even in the most mature Budget Support countries there were concerns about whether such support could be relied on. Despite this, the study found that donors were improving short-term predictability, with less progress on medium-term predictability. The Joint Evaluation cited the apparent special vulnerability of Budget Support to political risk and the inherently short-term nature of donors as predictability issues (IDD/OECD, 2006 in NAO 2008; Hubbard, 2007).

According to Koeberle (2006), there are various reasons why Budget Support commitments and disbursements seem to be more volatile in a few countries than other aid modalities, particularly in the initial stages. These include complicated internal donor procedures, non-alignment of donor and recipient budget cycles, politically-motivated commitments and poorly defined policy reforms. A recent study on aid predictability by ODI in Ghana, Tanzania and Uganda shows that all aid modalities are subject to degrees of unpredictability. While Budget Support could reduce the risk of unpredictable aid flows, it is not an assured solution (Hedger et al., 2010). The recent World Bank evaluation of PRSCs painted an equally modest picture, stating that they provided ‘somewhat’ more predictable funding than other aid modalities (World, Bank, 2010).

Such lukewarm results are concerning, as Budget Support was assumed to be predictable enough to fund a higher proportion of recurrent expenditure than other aid modalities. This has since been challenged and more recent evidence suggests that ‘perhaps the strongest result is that unpredictability tends to have a negative effect on the share of the development budget in total spending, both overall and at the sector level’ (Hedger et al., 2010; supported by Penrose, 2008). Findings from the Sector Budget Support in Practice study indicate that governments were reluctant to use Sector Budget Support to increase remuneration or mainstream service delivery staff, because the medium-to-long-term predictability of the support remained poor, and donor commitments short-term. This suggests that recipient countries have adapted their behaviour to reduce the risks of unpredictable aid. At the same time donors have tried to reduce the unpredictability of Budget Support, introducing programmes that commit them to longer-term commitments, such as the MDG contracts.

Positive transformational effect on government systems

One of the strongest arguments in favour of the ‘new’ Budget Support relates to strengthening public administration to make it more effective and accountable. This is driven by what Nilsson defines as *systemic effects* (the effects of a flow of funds that strengthens the system through its use) and *direct effects* (the effect of technical assistance in addition to the funds). Combined, these effects support government reform processes, particularly on public expenditure management, civil service reforms and result-based management (Naschold et al., 2002; Nilsson, 2004).

Most evidence in this area relates to the effect of Budget Support operations on a recipient country’s public financial management system. As early as the 2002 DFID evaluability study, there was a ‘generally upbeat response to this question’, with the lever of change being the focus on the national budget process (Lawson et al., 2002). Donors began focusing on budget processes and public financial management systems.

Driven by fiduciary risk and service delivery concerns, improvements in these areas became implicit desired outcomes for Budget Support operations (Nilsson, 2004). By 2006, the Joint Evaluation found that Budget Support was effective in strengthening public finance management, including planning and budgeting. This was particularly the case in countries where it had a track record of bringing funds on-budget and supporting their allocation and disbursement through regular Ministry of Finance channels.

Budget Support also helped to improve the comprehensiveness and transparency of partner govern-

ment public finance management, strengthening the basis for accountability (IDD/OECD, 2006). Despite these achievements, Lawson et al. caution against the expectation that many of reform actions will automatically facilitate a speedy implementation process and improvements in performance, as shown in Ghana (Lawson et al., 2007). In addition, reforms in public financial management may be less ambitious than portrayed. For example, the recent World Bank evaluation of PRSCs suggests that they generally facilitated improvements in ‘easier to tackle’ public financial management activities. A recent NAO report notes that those providing Budget Support were more likely to perceive improvements in public financial management and good governance than country officials who were not providing such support (World Bank, 2010; NAO, 2008).

There is less evidence on the effects of Budget Support on general civil service reform or corruption. It appears to have had less success in stimulating civil service reforms in developing countries (World Bank, 2010). There has been little analysis of its effects on corruption. Despite a common assumption that programme aid that is less directly controlled by donors is more open to fraud, evidence from the Joint Evaluation finds no evidence to support this. Instead it argues that General Budget Support is no more prone to fraud than other aid modalities (IDD, 2006 in Hubbard, 2007).

In addition to systemic and direct effects, Budget Support donors have influenced the effectiveness of public administration through their engagement in policies and policy processes. Recent evidence from the Sector Budget Support in Practice work suggests that donors have not addressed the ‘missing middle’ of service delivery, by failing to address the capacities and systems needed to manage, support and supervise frontline service providers. Therefore, although some central level functions have improved, the reach of Budget Support beyond public financial management functions and into service delivery capacities still needs strengthening (Williamson et al., 2010).

A more benign effect on domestic accountability

There was an expectation that the ‘new’ Budget Support would be less detrimental to domestic accountability than previous forms of programme aid. The assumption was that aid would be channelled through domestic systems and would focus on the government’s own accountability channels. In addition, as donors’ concerns began to shift from how well their project was faring to how well the government was managing the spending, it was anticipated that effort – through technical assistance – would be made to improve such domestic accountability systems. The latter is certainly true for DFID, with a higher proportion of beneficiary

countries using DFID Budget Support receiving technical assistance for domestic institutions than non-Budget Support countries (NAO, 2008).

There is limited evidence on the effect of Budget Support on domestic accountability. Instead, much of the debate has revolved around the existence of genuine ownership and the role of conditionality in Budget Support operations. It is acknowledged that there is a fundamental tension of providing Budget Support, as donors are trying to hand over ownership and accountability to national stakeholders whilst having to satisfy their own taxpayers that the resources are being put to sound use (Warrener, 2004).

Hubbard's analysis of the 2007 General Budget Support Joint Evaluation findings states that none of the case countries had strong domestic accountability, noting that weaknesses in policy planning and budget processes across many countries inhibited accountability. Despite this, he suggests that Budget Support at least stimulates debate over accountability (e.g. in Tanzania where civil society expressed concern about being excluded from government and donor processes), providing better information on which accountability can be assessed and helping to strengthen policy processes (Hubbard, 2007).

One reason for the limited research in this area is the complexity of the task. Domestic accountability systems are intrinsically complex, and patterned by formal and informal relationships, making it hard to carry out an accurate analysis of the influence of Budget Support on them. Evidence from the recent PRSC Evaluation indicates that supreme audit institutions and public financial management budget processes are more domestically accountable than in comparator non-PRSC International Development Association (IDA) countries, whilst 'surprisingly' the opposite seems to be the case for procurement systems. It goes on to say that, 'This variation in scores illustrates difficulties in attributing outcomes to actions, except in broad terms' (World Bank, 2010).

The complexity of domestic accountability systems may also impede the effectiveness of donors and Budget Support operations to support them. Donors often fail to appreciate how aid modalities and approaches interact with domestic power and accountability relationships, or understand how national systems can be supported while at the same time strengthening domestic accountability (Wild et al., 2010). This is supported by Paolo de Renzio's finding that donors in a number of countries undermine their capacity to play a more constructive role by being so involved in core policy processes. As a consequence, the strengthening of domestic accountability remains elusive and is being undermined inadvertently by those who want it strengthened (De Renzio, 2006).

Conditionality and policy dialogue

By limiting ourselves to the five benefit streams laid out in the 2002 evaluability study we have not adequately examined the role and scope of conditionality and policy dialogue. This is, however, a particularly important area of Budget Support operations, and one of the most contested and evidenced. It therefore merits some attention, albeit modestly, here.

The 'new' form of Budget Support was expected to represent a shift from the imposing nature of conditionality and policy alignment associated with the lending of the 1980s and 1990s. 'New' Budget Support was to promote a partnership-based approach, where recipient countries had greater input into programme design, policy dialogue and the conditions of the lending instrument. These would be based on government-led development strategies and hence a better sense of 'ownership' would be achieved.

By the time of 'new' Budget Support, numerous studies had recorded the failure of both policy and political conditionalities. The main sticking point was that where preferences of recipient governments and donors were misaligned, policy conditions did little to induce governments to change their preferences (Kizilbash et al., 2007). Examples of political conditions – those attached to improvements in governance – proved even less successful than (economic) policy conditions (Naschold et al., 2002).

Whether 'new' Budget Support has brought with it a 'new' type of conditionality seems to be contested. After approximately five years of 'new' Budget Support, Koeberle suggested that conditionality was now seen as 'somewhat of a misnomer' given the partnership nature of Budget Support operations (Koeberle, 2005, in Koeberle, 2006). A more cautious conclusion was reached by the Budget Support evaluations the following year, concluding that there was a spectrum rather than a sharp divide between the old and new conditionality (IDD/OECD, 2006).

Donors have certainly changed their approach to applying conditions over the last decade, but whether this has dramatically affected the success of such conditions remains to be seen. An assessment of the 'new' wave of policy dialogue came to many of the same conclusions noted by those criticising conditionality at the end of the 1990s (Kizilbash et al., 2007), while analysis of the EC governance incentive tranche suggests that it reflects many of the challenges associated with the aid modalities of the past (Molanaers et al., 2009).

Two things have clearly changed, however. First, it appears that policy dialogue has strengthened following the shift to 'new' Budget Support. Initially, a greater emphasis was placed on an approach based on policy dialogue, where the overall assessment of a country's performance gained increased weight com-

pared to specific targets (Knoll, 2004). Ownership was also facilitated, as policy dialogue focused more on the national budget priorities expressed by national government plans such as the PRSPs, with governments appearing to own the policy process more (Lawson et al., 2002; Lawson et al., 2007). This is perhaps reflected in their strong preference for Budget Support over other aid instruments (NAO, 2008).

Despite improvements, policy dialogue does not appear to be used to its full potential (ECA, 2010). Criticisms surround the weak capacity of those involved in policy dialogue (both from the donor and recipient country perspective), the lack of appropriate dialogue strategies and weaknesses in adequately targeting policy dialogue, e.g. on the binding constraints of service delivery for Sector Budget Support (ECA, 2010; Williamson et al., 2010).

A second development is the reduction in the number of conditions per lending instrument and an increase in the flexibility with which they have been applied (World Bank, 2010). However, with the case for political conditionality gaining momentum in EC member states this trend might reverse. Given the weak evidence-base surrounding the effectiveness of conditionality and the affect this will have on increasing conditions in Budget Support operations, such an approach seems ill-advised. That said, Budget Support has always been vulnerable to deteriorating political relations, with many disbursements being withheld for political reasons, including, in recent years, Ethiopia, Honduras, Madagascar, Nicaragua, Rwanda and Uganda (Naschold et al., 2002; Koeberle, 2006; NAO, 2008).

Informal political conditionality has existed for some time. Making it formal and explicit might 'signal' expectations more effectively in an effort to secure performance. Yet, the old caveat remains: unless conditions are mutually agreed by both the recipient government and donor/s (as well as amongst themselves), evidence suggests that conditionality will do little to facilitate performance.

A better understanding of the process of arriving at conditionalities is required to facilitate a process where government and donor preferences are *really* aligned. More attention should also be given to the political economy of Budget Support operations to examine, comprehensively, the incentives involved in such operations.

Delivering better Budget Support

Drawing on the analysis above, this section highlights seven areas where Budget Support design can be strengthened against its original rationale.

- A set of clear, prioritised objectives for Budget Support should be established by Budget Support donors

(and preferably jointly). Improved clarity on what donors expect from Budget Support will improve both its design and implementation and ensure greater realism in the design of conditionality.

- Better data on transaction costs should be collected and definitions clarified, building on work by Lawson (2009). Improved understanding will help stakeholders remove bottlenecks that continue to prevent the reduction of transaction costs, such as insufficient progress in the harmonisation and alignment of Budget Support operations, weak policy dialogue and derogations from country systems.
- A more sophisticated methodology is needed to measure how the allocation of public expenditure is improved through Budget Support. Such improvements should be tied to the prioritisation of its ultimate objectives. For example, the pattern of spending needed to improve poverty reduction or broad-based economic growth may differ from that supporting economic growth.
- The objective of minimising the unpredictability of aid flows needs to be returned to centre-stage. Conditionality frameworks should be designed to take better account of their impact on incentives and trade-off any benefits from 'improved leverage' with damaging reductions in the predictability of Budget Support.
- Efforts to improve central government functions, particularly on public financial management, should be maintained by limiting derogations from the use of country systems in the design of Budget Support programmes. A stronger focus is needed on improving public administration beyond public financial management.
- To strengthen institutions and domestic accountability more effectively, officials involved in policy dialogue need to be better informed of the distinctive strengths and weaknesses of the institutions of particular countries, as well as how their approach impacts on power and accountability structures.
- The stock of evidence that examines or tests Budget Support needs to be increased. More effort should be made to measure the impact of Budget support on its ultimate objectives. The results of the upcoming OECD/DAC sponsored evaluations should shed light on such an approach. There is also a need to explore analysis that compares Budget Support with other aid modalities.

Written by Heidi Tavakoli, ODI Research Officer (h.tavakoli@odi.org.uk) and Gregory Smith, Crown Agents. The authors would like to thank David Booth for his review and inputs.

Endnotes and references

Endnotes:

- 1 Before the 'new' Budget Support provided since the late 1990s, programme aid focused on stabilisation and adjustment objectives, and included balance of payments support. Such funding was provided with policy dialogue but often without attention to institutional reform, aid effectiveness principles or the provision of technical assistance; which came to define the support package offered by the 'new' form of Budget Support. The move from the 'old' to the 'new' forms of Budget Support reflected a shift in focus from stabilisation, to growth and poverty reduction.

References:

- Beynon, J. and Dusu, A. (2010) 'Budget Support and MDG Performance', EC Development Paper No. 2010/2011, March.
- Booth, D. (2008) 'Good governance, aid modalities and poverty reduction – from better theory to better practise'. Research Project (RP-05-CG) commissioned by the Advisory Board for Irish Aid. London: ODI.
- Brown, A., Naschold, F., Conway, T. and Fozzard, A. (2000) 'Aid Transaction Costs in Vietnam,' Report for DFID. Lond: ODI.
- Cavalcanti, C. (2007) *Reducing the Transaction Costs of Development Assistance Ghana's Multi-Donor Budget Support (MDBS) Experience from 2003 to 2007*. Policy Research Working Paper (<http://ssrn.com/abstract=1032029>).
- Cordella, T. and Dell'Ariccia, G. (2007) *Budget Support versus project aid*. IMF Working Paper WP/03/88. Washington, DC: IMF.
- Caputo, E., Lawson, A., and van der Linde, M. (2008) 'Methodology for Evaluations of Budget Support Operations at Country Level, Issues Paper'. Report for the EC, May.
- De Renzio, P. (2006) 'Aid, Budgets and Accountability: A Survey Article', *Development Policy Review* 24 (6): 627-645.
- European Court of Auditors (ECA) (2010) 'The Commission's Management of General Budget Support in ACP, Latin America and Asian Countries', Special Report No 11//2010.
- European Commission (2010) 'The Future of EU Budget Support to Third Countries'. Green Paper from the EC to the Council, European Parliament, European Economic and Social Committee and Committee of the Regions, Brussels, COM(2010) 586.
- Elbers, C., Gunning, J. and de Hoop, K. (2007) *Assessing Budget Support with Statistical Impact Evaluation*. Tinbergen Institute Discussion Paper, TI 2007-075/2.
- Foster, M. and Leavy, J. (2001) *The Choices of Financial Aid Instruments*. ODI Working Paper 158. London: ODI.
- Frantz, B. (2004) 'General Budget Support in Tanzania: A Snapshot of Its Effectiveness, Preliminary Draft Version': 20 February (mimeo).
- Hedger, E., Killick, T. and Smith, G. (2010) 'Extent, Influences on, and Consequences of Aid Unpredictability', Synthesis Report, October. London: ODI.
- Hubbard, M. (2007) 'Entitlement, Rules, Coordination, Club, Market and Hierarchy: General Budget Support in Practice and Theory, Implications of the Results of the Joint Evaluation of General Budget Support'. UNU-WIDER, Research Paper No.2007/39, June. Helsinki: WIDER.
- IDD and Associates/OECD (2006) 'Joint Evaluation of General Budget Support Synthesis Report'. International Development Department.
- Killick, T. (2004) 'Politics Evidence and the New Aid Agenda', *Development Policy Review* 22 (1): 5-29.
- Kizilbash, Z. and Lawson, A. (2007) 'What is new in the 'new' thinking on Policy Conditionality and what are the implications for Development Agencies?', unpublished working paper.
- Knoll, M. (2008) *Budget Support: A Reformed Approach or Old Wine in New Skins.*, United Nations Discussion Papers, United Nations Conference on Trade and Development No. 190, October. New York: UNCTAD.
- Koerberle, S. and Stavreski, Z. (2006) 'Budget Support: Concepts and Issues' in *Budget Support as More Effective Aid? Recent Experiences and Emerging Lessons*. Washington, DC: World Bank.
- Lawson, A., Booth, D., Harding, A., Hoole, D. and Naschold, F. (2002) 'General Budget Support Evaluability Study, Phase 1, Final Synthesis Report'. Report to the UK Department For International Development, 30 December. Oxford: Oxford Policy Management and London: ODI.
- Lawson, A. and Booth, D. (2004) 'Evaluation Framework for General Budget Support.' Report to Management Group for the Joint Evaluation of General Budget Support, February.
- Lawson, A., Booth, D., Msuya, M, Wangwe, S and Williamson, T. (2005) 'Does Budget Support Work? Evidence from Tanzania'. London: ODI.
- Lawson, A., Boadi, G., Gharthey, A. Gharthey, A., Killick, T., Kizilbash Agha, Z. and Williamson, T. (2007) 'Joint Evaluation of Multi-Donor Budget Support to Ghana, Based on OECD Methodology, Volume One: Evaluation Results and Recommendations on Future Design and Management of Ghana MDBS, Final report'. London: ODI.
- Lensink, R. and Morrissey, O. (2000), 'Aid Instability as a Measure of Uncertainty and the Positive Impact of Aid on Growth', *Journal of Development*.
- Naschold, F. and Booth, D. (2002) 'General Budget Support Evaluability Study, Literature Review', Second Draft. London: ODI.
- National Audit Office (2008) 'Department for International Development, Providing Budget Support to Developing Countries'. Report by the Controller and Auditor General, HC Session 6 2007-2008, 8 February.
- Nilsson, M. (2004) *Effects of Budget Support – A Discussion of Early Evidence*. UTV Working Paper 2004:4.
- Molenaers, N. and Nijs, N. (2009) 'From the Theory of Aid Effectiveness to the Practice: The European Commission's Governance Incentive Tranche', *Development Policy Review* 27 (5): 561-80.
- Penrose, P. (2008) 'European Commission Budget Support Programmes: Nature, Dialogue and Design', Think Piece.
- Warner, D. (2004) 'ODI Synthesis Paper 4: Current thinking in the UK on General Budget Support'. London: ODI.
- Wild, L. and Domingo, P. (2010) 'Aid and accountability in health: key themes and recommendations', ODI Project Briefing. London: ODI.
- Williamson, T. and Dom, C. (2010) 'Sector Budget Support in Practice, Synthesis Report'. London: ODI.
- World Bank (2010) 'Poverty Reduction Support Credit (PRSC) – An Evaluation of World Bank Support'. Washington, DC: Independent Evaluation Group, World Bank.

Overseas Development Institute, 111 Westminster Bridge Road, London SE1 7JD, Tel: +44 (0)20 7922 0300, Email: publications@odi.org.uk. This and other ODI Background Notes are available from www.odi.org.uk.



Readers are encouraged to reproduce material from ODI Background Notes for their own publications, as long as they are not being sold commercially. As copyright holder, ODI requests due acknowledgement and a copy of the publication. For online use, we ask readers to link to the original resource on the ODI website The views presented in this paper are those of the author(s) and do not necessarily represent the views of ODI. © Overseas Development Institute 2011. ISSN 1756-7610.