Overseas Development Institute

Pieces of the puzzle:

evidence, dilemmas and the emerging agenda for budget support

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Edited by Heidi Tavakoli and Edward Hedger

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Executive summary and key messages

This report summarises discussions and conclusions from a series of expert meetings on budget support organised by the Centre for Aid and Public Expenditure (CAPE) at the Overseas Development Institute (ODI) in 2011.

The following section summarises the key messages from each of the five meetings of the series. This is followed by a broader introduction and background to the meeting series and budget support and then the individual chair's summary for each event.

Measuring and demonstrating results

In the current fiscal climate, there is increasing pressure on donors to show the value for money (VfM) of aid and the modalities through which it is provided, including budget support. In order to achieve this, there is increasing appetite for evidence that demonstrates the results of budget support (i.e. outcomes and impact) in a way that provides a better sense of attribution, not just contribution.

Historically, analysis of budget support has focused primarily on its institutional effects, rather than on end results. This is largely because the perceived institutional benefits were seen as the original justification for budget support, and because complex intervention frameworks and data weaknesses have made it methodologically difficult to focus primarily on results.

More comprehensive methodologies and sophisticated techniques have created the opportunity for a more complete assessment of budget support, as shown by budget support evaluations in Mali, Tunisia and Zambia in 2011 (Caputo et al., 2011). More attention has been given to assessing the results of budget support through the use of new techniques to measure impact, and greater effort has been made to examine other factors that affect budget support operations, including political economy issues and the spill-over effects of modalities. Yet, difficulties with data availability and quality continue to generate evaluation challenges.

Risks of misuse of funds and corruption associated with budget support operations continue to be a concern for domestic audiences in donor countries. However, the question of causality is rarely examined—for example, has the budget support operation increased the opportunities for leakage of funds or rather merely increased the detection of such leakages? Another knowledge gap relates to the comparative VfM of aid instruments. For example, the cost of leakage through using relatively weak country systems should be weighed against the full cost entailed in using alternative aid delivery mechanisms (such as external service providers).

A more holistic understanding of the VfM of budget support is needed. This would take account of the short-, medium- and long-term effects of aid instruments. It would also incorporate factors such as service delivery quality (rather than just the financial cost), and would compare the most realistic alternatives to budget support. For example, budget support operations should be appraised against a portfolio of project interventions (i.e. not just a single project) as this is the most likely alternative.

Political economy issues and budget support

Assessing the appropriateness of the theory of change underlying budget support should be a priority for evaluations. To date, evaluations of budget support have focused on examining what has worked and why (Booth, 2011). Development practitioners should be more explicit about the theory of change underlying their budget support delivery mechanism, and then assess whether the set of implicit assumptions made about recipient country and donor behaviour has reflected actual practices fully and correctly.

Implicit assumptions are often made about budget support and recipient country behaviour that are not necessarily grounded in evidence. For example, it is assumed that service personnel performance is responsive to the better and more pro-poor funding and management that budget support provides. However, evidence on the performance of sector budget support (SBS) shows that downstream bottlenecks in personnel management and motivation remain, and that these adversely affect the quality of services. Such incentives do not change automatically and have rarely been the concern of SBS working groups (Booth, 2011).

Establishing the best ways to leverage performance to achieve results from budget support will mean ensuring accuracy in the proposed benefit streams, and in their basic assumptions to determine why budget support works in some situations and not others.

There are clear tensions between the incentives facing donor country politicians and those relating to development practitioners with regard to budget support operations. The pressures on politicians are often at odds with what is necessary for effective budget support delivery. First, politicians have short time horizons within which to show the results of development assistance, whereas budget support requires long-term sustained commitment. Second, aid serves many purposes for politicians, including development, diplomacy and democracy promotion, so the effectiveness of budget support is often undermined by an overloading of objectives. Third, politicians require direct and visible results that are easy to measure and attribute, whereas budget support offers indirect (and sometimes intangible) results that can be hard to measure and suggest only contribution (Molanaers, 2011).

Donor governments apply conditions to aid delivery in part to respond to expectations from their domestic constituencies. Conditions linked to political and particularly democratic governance appear to be gaining political traction in Europe, playing an important role in making aid palatable to donor country publics. Yet, some of the tensions between what donor politicians favour and what is required for budget support to be effective could be eased if donor and recipient governments were better at communicating the merits (and costs) of different approaches. This means presenting development aid as a long-term institution-building process, instead of as a transaction to achieve quick results such as schools built and children vaccinated. Better communication should improve public understanding and tolerance of the risks inherent in aid delivery.

Budget support in fragile states

Budget support has often been provided to fragile states early in the post-conflict period. General budget support (GBS) in particular tends to represent a small percentage of official development assistance (ODA) in fragile states (approximately 5% between 2002 and 2009), but some fragile states have received as much GBS as the stable low-income countries that receive the highest proportions of budget support (Dom and Gordon, 2011).

In most non-fragile states, GBS has been increasing over the past decade, whereas in fragile states it has been very erratic, with no such upward trend evident (Dom and Gordon, 2011). This can be explained by donor approaches to budget aid in fragile states. According to the World Bank/European Union (EU) Common Approach Paper, these approaches are characterised by short-termism, irregular resource flows, standardised programmes, poor knowledge of political economy issues and an overwhelming focus on fiduciary risk (Pontara, 2011).

Discussion focused on three main ways to improve the effectiveness of budget aid in fragile states. First, budget aid should address more explicitly the causes of fragility and work to facilitate improved state building, by targeting areas such as justice, security and jobs. Second, strengthened risk management entails establishing a more comprehensive understanding of risk, developing programmatic approaches to distribute risk across a range of modalities and setting up continuous assessment of the evolving risks in operations. Third, improved donor coordination at a country level is a priority, especially since it is typically much weaker in fragile states than in other contexts.

There is no observed correlation between the use or level of GBS and the fragility of countries or their Human Development Index (HDI) trends (Dom and Gordon, 2011). This implies that other factors have determined choices to invest. Three factors affecting these choices were discussed. First, the waning political appetite for budget support in general in donor countries has made these countries less willing to provide such support in fragile states without additional political governance conditions and fiduciary safeguards. Second, set against this trend is the strong demand for budget support from an increasingly vocal group of recipient country governments, notably the g7+ group of fragile states. Third, negative connotations have started to become associated with the label of 'budget support' itself.

Certification for budget support operations

Budget support donors typically vary the volume of their aid according to the quality of governance,[1] but this is flawed, given the principle that aid volumes should also respond to need. According to the Tinbergen rule, donors need as many aid instruments as they have objectives. The two main aid objectives can be defined as 'countries' needs' and 'aid effectiveness'. To address these objectives two instruments are required: the volume of aid and the choice of modality through which it is delivered. According to this framework, the amount of aid allocated should be tied to the country's need, whereas the modality should be determined through an assessment of the recipient's capacity to use the aid effectively. The main variable that should define which modality to use should be the quality of governance in the recipient country (as typically measured by indices such as Country Policy and Institutional Assessment (CPIA)). However, budget support donors have often varied the volume of aid, rather than the modality, in line with the quality of governance (Collier, 2011).[2]

International budget certification is one proposed way to address this challenge in budget support operations. Performance of the recipient country's governance conditions would then determine the choice of aid modality and whether countries are 'fit' or 'not fit' to receive budget support. In budget support operations, budget certification of a recipient country's public

1 Here, governance conditions refer loosely to public sector governance conditions.

2 Although there is no written reference sourced in the report for these points, they were presented by Paul Collier during the fourth meeting of the series.

financial management (PFM) system would become a *de facto* minimum requirement. The main argument for certification is that it would create strong incentives for politicians in aid-recipient countries to prioritise the strengthening of PFM systems. Such an approach could also better address the fears of donor country taxpayers about wastage through corruption and misuse (Collier, 2011).

However, there are questions as to how a certification process would operate in practice. The main challenges centre on establishing appropriate criteria; monitoring and assessing actual performance (i.e. *de facto* not just *de jure*); selecting the right institution to be the independent certifier (e.g. private sector accountancy firms would have incentives to set the certification standards artificially high); and developing an appropriate alternative delivery modality for those countries that fail the certification process.

A system of budget certification would reduce the scope for improving the quality of governance through budget support operations. Budget support operations are often instrumental in strengthening PFM, even if progress has been only modest in some cases. Therefore, rather than switching to modalities that lose these potential effects, donors should explore ways to manage fiduciary risks more effectively through budget support operations. This could be achieved by introducing more intrusive fiduciary safeguards, such as procurement audits, replenishment schemes, earmarking and community accountability, as well as through improved transparency of systems and aid data.

Innovative approaches in relation to performance and results

The growing prominence of the results agenda has prompted innovations in the design of budget support-type modalities. Three sets of instruments suggest some of these innovations: the European Commission (EC) Millennium Development Goal (MDG) Contract and GBS Variable Tranche; the new World Bank Program-for-Results (P4R); and the Center for Global Development (CGD) Cash on Delivery (CoD) concept (see table below).

These instruments all share the feature of using government systems. However, they imply different strategies for strengthening capacity and mitigating operational risks, as demonstrated by the different roles assumed for donors. The EC and P4R instruments encourage a more intrusive role for donors, providing capacity-building support alongside incentives for results. By contrast, the CoD approach argues that traditional development approaches are cumbersome and prescriptive and hamper performance. It assumes that recipient countries are best placed to achieve results and should be given the policy space to lead and manage this process. It follows that partner country governments have the commitment and capabilities to address the bottlenecks to achieve results.

Evidence on the effectiveness of these new approaches in practice remains very limited. To date, only the EC instruments have been implemented. More evidence is needed, but early analysis of the EC variable tranches indicates a positive incentive effect over the medium term. Anecdotal findings suggest MDG Contracts have performed strongly in some countries, but there have not been any programme evaluations.

The discussion covered the following design and implementation issues: challenges in measuring and managing for results; complementarity between results-based aid and other aid instruments and the potential trade-off between sector-based instruments and budget support; and the appetite for results-based instruments from both donor and recipient country perspectives.

The way forward

There is growing acceptance that the continued use of budget support depends on the ability of aid specialists to develop innovative approaches that can respond to growing political concerns in pragmatic and realistic ways. Recommendations emerging from the ODI meeting series are summarised overleaf.

GBS Variable Tranche	MDG Contract	P4R	CoD
• Subject to eligibility criteria • Financing linked to progress against targets • Incentivises performance in budget support operations (40% of budget support operations in the 9th European Development Fund (EDF))	• A longer-term, more predictable form of GBS (6 years not 3) • Focused on results • Targets strong performers	• Finances a government programme (specific sector, subsector, national or sub-national programme) • Disbursements primarily against agreed results achieved • Funding matched with capacity-building support	• Payments in proportion to outcomes • Recipient agenda setting • Results verified independently and publically available • Would complement other funding modalities

Improve the measurement and demonstration of results

- Continue to implement innovative methodologies to provide a more complete assessment of budget support operations. Encourage a more comprehensive approach to assessments and a greater use of impact assessment techniques.

- Support the production of more regular and better datasets on development results and on budget support commitments and disbursements. Encourage better programming of evaluations by timing them to coincide with poverty surveys and public expenditure reviews, to allow for use of current data. Introduce ongoing monitoring of budget support operations.

- Take a more holistic approach to assessing VfM and assess fiduciary risk in relation to other instruments.

- Evaluate the 'programme theory' for budget support to establish an appropriate set of assumptions of recipient and donor behaviour. Express this more explicitly in budget support operations.

Explore innovative approaches to delivering results

- Establish a hierarchy of objectives and expectations for budget support operations, which are clearer and, in some cases, less ambitious.

- Explore ways to leverage performance based on a more appropriate programme theory and assessment of the incentives facing different stakeholders. This includes exploring innovative ways to address downstream service delivery bottlenecks related to the management, delivery and accountability of services so as to incentivise results. Ensure flexibility to adjust these mechanisms to reflect a changing understanding of political economy realities.

- Determine an appropriate division of responsibility between recipient governments and donors, informed by recipient country circumstances and preferences.

- Use budget aid in fragile states to more explicitly address the causes of fragility and the factors that can facilitate improved state building, such as jobs, security and justice.

- Engage donor constituencies in a more mature debate about development processes and results, the role of aid and its inherent risks and the relative merits of different funding modalities. Work to reduce the tension between the incentives donor politicians face and what is necessary for effective budget support.

Understand risk more fully and address it more effectively

- Develop a framework for designing budget support operations which allows for a more sophisticated assessment of the types and degrees of risk associated with its delivery. Strengthen risk management by establishing a more comprehensive understanding of risk, developing programmatic approaches to distribute risk across a range of modalities and setting up continuous assessment of the evolving risks in operations.

- Explore the relative merits of proposed approaches to better address fiduciary risk and work actively to improve the management of such risk. Assess the relative merits of establishing an international budget certification system, or equivalent minimum standards, versus a more intrusive approach to budget support operations which applies additional fiduciary safeguards and the improved transparency of systems and aid data.

- Move away from the strict dichotomy between budget support and project support towards a broader menu of aid instruments that combines features of both, based on the evidence on what is effective.

- Explore the development of more formal portfolio approaches to better accommodate changes in different types of risk.

1 Introduction

Over the past decade, the international community has come to champion budget support. Supported by donors and recipient countries alike, it has grown in prominence to make up a significant share of aid spend by some donors. Between 1995 and 2005, GBS accounted for over 20% of UK and EU aid to least-developed countries (LDCs) (Manuel, 2011).

Yet, budget support was hardly mentioned in documentation for the Busan Fourth High-level Forum on Aid Effectiveness, and the UK Department for International Development (DFID)—once a key proponent—is likely to cut GBS by 43% between 2011/12 and 2014/15.

In the context of a growing political consensus around the results-based agenda, there are concerns that, unless budget support can be shown to deliver broader development results without posing excessive reputational risks, the donor preference for it may diminish. So the challenge was set to explore the complex interactions that constitute budget support and its results.

In response to the current climate, ODI hosted a meeting series with a consortium of experts to try to piece together the puzzle of budget support. The purpose was to allow prominent researchers, consultants and policy advisors to discuss some of the key questions and themes surrounding budget support today; to analyse the experience of giving aid through budget support over the past 10 years; and to draw out lessons learnt to address some of challenges facing its use in the current aid environment. The meeting series was aimed at a donor audience, primarily, although not exclusively, participants from UK and European institutions.

This report is structured around the main meetings of the series, presenting the chair's summary for each meeting in turn. The table below details the content of the meetings.

Meeting topics and speakers

Date	Topic	Speakers
22 March 2011	Recent lessons from evaluations	**Chair:** Marcus Manuel, Director of Budget Strengthening Initiative, ODI **Speakers:** Andrew Lawson, Director of Fiscus Enzo Caputo, Development Researchers' Network Associate Antoine de Kemp, Senior Evaluator, Netherlands Ministry of Foreign Affairs
8 April 2011	The political economy of budget support	**Chair:** Andy Norton, Director of Research, ODI **Speakers:** David Booth, Director of African Power and Politics Programme, ODI Nadia Molenaers, Lecturer, University of Antwerp
9 May 2011	Budget support in fragile states	**Chair:** Marcus Manuel, Director of Budget Strengthening Initiative, ODI **Speakers:** Catherine Dom, Principal Consultant, Mokoro Nicola Pontara, Senior Economist, World Bank
8 June 2011	Budget support and budget certification—Is it the way forward?	**Chair:** Alison Evans, Director of ODI **Speakers:** Paul Collier, Director, Centre for the Study of African Economies, Oxford University Mick Foster, Senior Research Associate, ODI Marcus Manuel, Director of Budget Strengthening Initiative, ODI
21 September 2011	Results and innovative approaches	**Chair:** Edward Hedger, Head of Centre for Aid and Public Expenditure, ODI **Speakers:** Jonathan Beynon, Senior Policy Advisor, EuropeAid Fadia Saadah, Investment Policy Group Manager, World Bank William Savedoff, Senior Research Fellow, Center for Global Development

2 Background

Budget support in various forms has been around for over 50 years. It objectives and processes may have changed, but the principles of delivering aid directly to government budgets and using government systems remain.

The development of what became known as the 'new' form of budget support in the late 1990s, with objectives tied primarily to poverty reduction and growth, stemmed predominantly from dissatisfaction with the negative institutional effects of the previous dominant aid modalities, particularly project-based aid.

The new form of budget support was perceived to offer the opportunity to enhance a government's capacity to reduce poverty, because it would have a positive transformational effect on government systems and a more benign effect on domestic accountability. It was also seen to reduce the transaction costs of aid delivery, improve predictability and encourage greater allocative efficiency of public expenditure (Lawson et al., 2002; Naschold and Booth, 2002).

The purpose of budget support is to contribute to the implementation of general or sectoral strategies. It is a package of support (financial transfers, policy dialogue and capacity building) based on a partnership approach. It is channelled directly to a recipient government's treasury account and thereafter executed using the country's own allocation, procurement and accounting systems (DRN et al., 2008). Donors complement this financial support with policy dialogue, performance assessments and capacity building so as to strengthen the domestic policy and budget processes. A distinction has developed between GBS, which aims to contribute to broader national development plans or poverty reduction strategies, and SBS, which targets sector-specific goals.

Although a consensus grew around the need for budget support, supported by principles espoused at global aid effectiveness conferences, no such consensus materialised around a precise rationale, set of expectations and objectives, either across development practitioners or over time. This has created challenges in measuring the performance of the instrument, as there has been no commonly held rationale against which its performance can be assessed. It has also meant that different donor expectations of budget support have often been reflected in their approach (Tavakoli and Smith, 2011).

Other challenges have surfaced related to the paucity of data on the impact of budget support—even though there is more evidence on its other effects—widely reported-on developments related to fiduciary risk, for example corruption scandals, and the provision of budget support to governments with weak commitment to fundamental values.

In an economic climate which has led donors and their constituencies to become increasingly aware of the opportunity cost of aid spending, these challenges have fuelled a change in attitude, away from budget support in its current form, as expressed more recently by many European donors. Yet, observers suggest that this change in donor attitudes has been driven primarily by political concerns about reputational risks associated with budget support as opposed to evidence on its performance.

For this reason, the ODI meeting series was organised to reflect on evidence and experience in budget support over the past 10 years, so as to facilitate a more evidence-based discussion during which lessons, experience and suggestions for the way forward could be shared.

3 Recent lessons from evaluations: chair's summary

Chair: **Marcus Manuel**, Director of Budget Strengthening Initiative, ODI
Speakers: **Andrew Lawson**, Director of Fiscus
Enzo Caputo, Development Researchers' Network Associate
Antoine de Kemp, Senior Evaluator, Netherlands Ministry of Foreign Affairs

The meeting series was opened by Alison Evans, Director of ODI. She described the original rationale for budget support and its development over the past 10 years, noting that budget support had become a critical tool for delivering country ownership and policy reform. She also noted that, during its inception, practice had to some extent run ahead of evidence, and also commented on the timeliness of the meeting series and pointed to its role in preventing the reoccurrence of such practice in a time when donors are carefully examining their budget support operations.

The purpose of the first meeting was to showcase and discuss evidence from recent evaluations of budget support. The methodology used and the emerging findings of OECD Development Assistance Committee (DAC)-sponsored budget support evaluations in Mali, Tunisia and Zambia were presented. The session covered issues related to evaluation methodologies, the emerging findings of the new evaluations and their policy implications.

Presentations[3]

Enzo Caputo started the meeting with a presentation on the methodology for the evaluations and on findings from the **Tunisia** case study. He outlined the methodology's three-step approach, which aims to build on and improve the intervention framework used in past budget support evaluations. As shown in the figure below, the first step covers the relationship between the first three levels of the comprehensive evaluation framework: budget support inputs, direct outputs and induced outputs (government policies). The second examines the relationship between the last two levels of the framework: outcomes and impacts. The third compares the results of the previous steps and identifies the contribution of budget support to outcomes and impacts, via government policies. The second step is the main innovation compared with other budget support evaluation approaches, as it allows for an investigation of the actual processes that have occurred and the factors that have led to the achievement or non-achievement of the intended outcomes and impacts. This step is made up of a political economy assessment and various kinds of quantitative analysis.

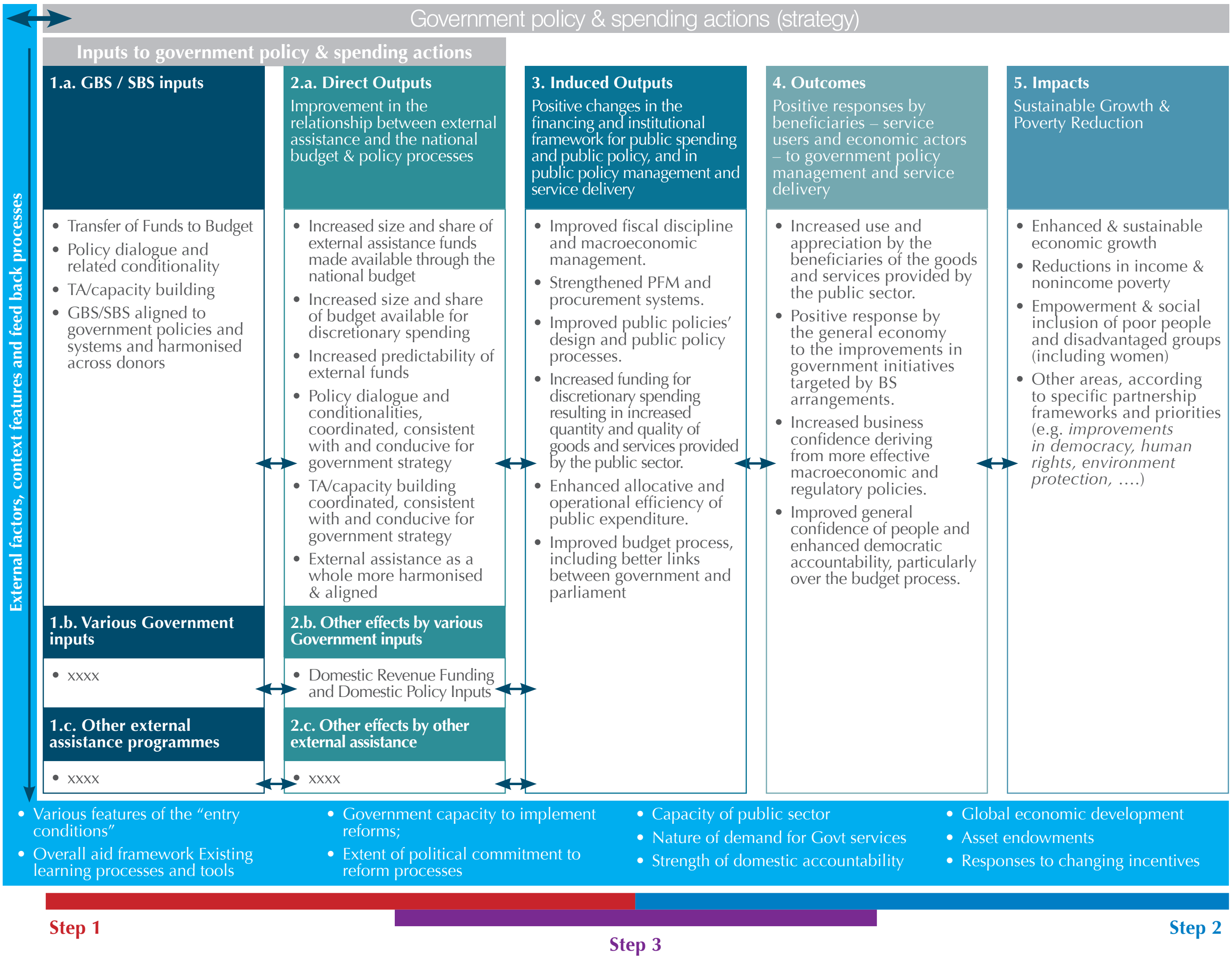
Enzo Caputo then went on to discuss how the methodology was applied to the Tunisian case, where GBS amounts to 1–2% of the budget. He explained the historical government and partner set-up in Tunisia and, in discussing the challenges involved in carrying out the evaluation, noted that the identification of evaluation questions had been one of the most delicate issues.

For Step 2, an overview of the economic policy history of Tunisia was carried out, as well as three combined types of statistical analysis: a *cluster analysis on six countries of the region*, to identify the specific factors linked to economic and social growth in each; a *statistical regression on Tunisia*, to identify the relationship between two dependent variables (gross national product (GNP) per capita growth and the HDI) and a number of variables related to policy and non-policy factors; and a *dynamic panel data analysis*, to better capture the relationship between specific policies over time and intended results. Following this, results from the quantitative and political economy assessments regarding the determinants of economic growth and social change were compared, and commonalities were found between them.

In order to examine how budget support operations had supported the achievement of the intended outcomes and impacts, Step 3 involved comparing the results of Step 2, which identified factors—including government policies—that had influenced Tunisia's intended outcomes and impacts, with those of Step 1—which showed how budget support had contributed to the implementation of such government policies.

3 At the time of the meeting, the partners were still considering the results of the evaluation reports, so presentations made were of preliminary emerging findings only.

Budget support evaluation framework: the three-step approach



Source: Caputo (2011).

In the case of Tunisia, the method was able to capture the following results:

- Some *key political choices* made by different governments which (over the years) had been at the root of their performance (Step 2);
- The fact that the continuity and development of such policies would not have been possible without the *Association Agreement* and the opportunities of economic, social and cultural integration this has provided (Step 2);
- The Association Agreement needed an intensification and acceleration of the reform process which the country would not have been able to perform without an appropriate support programme (Budget Support – Step 1).

Antoine de Kemp presented the second case study, on **Zambia**, noting the following positive findings:[4]

- Positive development of monetary and fiscal policy;
- Strengthening of PFM and the position of the Auditor-General;
- Increased expenditure on social sectors and some improvements in service delivery.

However, several challenges remain, such as slow improvements in key areas, regressive budget allocations and sometimes limited ownership of important reforms. Poor performance may be explained by some of the challenges facing the government of Zambia and cooperating partners. For donors, such issues have

4 This evaluation is a joint endeavour of the Evaluation and Audit Department of the German Federal Ministry for Economic Cooperation and Development (BMZ-E), the Policy and Operations Evaluation Department of the Netherlands Ministry of Foreign Affairs (IOB) and the Secretariat for Evaluation of the Swedish International Development Cooperation Agency (Sida). The evaluation is being carried out by the German Development Institute (DIE), the Amsterdam Institute for International Development (AIID), the German Development Bank (KfW), Oxford Policy Management (OPM) and IOB.

related to the unfinished harmonisation agenda, the overloaded policy dialogue and Performance Assessment Framework (PAF) and unrealistic donor expectations. The latter concern was noted with regard to poverty rates and education sector outcomes: donors have been critical about slow progress in both areas, without fully accounting for the factors that have undermined performance, for example the effect of the very weak starting point for the education sector, as well as that of high population growth on poverty rates.

Antoine de Kemp also commented on some of the challenges faced when carrying out the evaluation. For example, there is a very weak/non-existent joint knowledge system on budget support operations in Zambia, and therefore the most elementary of data were difficult to get hold of. In addition, poverty data are fairly old. Moreover, a 'congestion of evaluations' in Zambia reflects a lack of harmonisation, which has had a negative impact on the objective to reduce transaction costs.

Andrew Lawson started his presentation by laying out the four levels of objectives in budget support, related to empowering and strengthening government systems and promoting growth and reducing poverty. He then explained how budget support actually works, dividing the process into three types of effects: flows of funds effects; endogenous policy and institutional effects; and exogenous policy and institutional effects. He noted that, although past evaluations have made reference to the impact of budget support operations, none has been able to get at poverty issues effectively. This is explained in part by the fact that the primary interest of the audience of previous evaluations was in inputs, outputs and process issues. In addition, the evaluations have not been sufficiently well resourced to address impact effectively.

Andrew Lawson explained how the new evaluations have attempted to improve the assessment of impact. This has first been through more careful quantification of the changes in funding composition (aid modalities) and the subsequent spending and borrowing by partner governments. In **Mali**, budget support is around 14% of the total budget. Given issues surrounding the weak predictability of budget support, it was found that the government was treating it as marginal revenue and hence marginal spend. In doing so, using historical budget allocations as guidance, the evaluation estimated that budget support in Mali had been used to fund domestic capital spending and non-salary recurrent expenditure—both considered to be marginal expenditure items. Andrew Lawson suggested that this was a more accurate way of attempting to estimate the allocative effect of budget support in comparison with previous attempts, which crudely suggested that budget support funded x% of all expenditure.

Second, Andrew Lawson suggested that impact can be better estimated by dedicating greater resources to examining the outcomes and impact of budget support. This has been achieved by examining the evolution of poverty and how it may have related to policy changes; measuring sector outcomes; and also looking at changes in the environment for private sector development and its relationship to policy changes.

Discussion points

Issues related to **corruption and VfM** were raised several times during the discussion, and the VfM of budget support was seen to be a key part of the debate going forward. Risks of corruption associated with budget support operations continue to be a concern for domestic audiences in donor countries. There was a question of causality—does budget support increase the opportunities for corruption or rather increase the detection rate? There was a general feeling that VfM should be considered when examining the costs of corruption. For instance, budget support may well already be better VfM than other modalities, despite leakages through corruption, as the unit costs for budget support-funded services are often lower than those funded by project support (although the quality of the outputs also needs to be factored in).

When considering VfM, the net costs of budget support operations should be compared with the net costs of multi-aid projects, as in reality the budget support counterfactual is rarely one project, but many. A holistic review is also needed. Budget support is aimed at strengthening government systems, whereas projects often have unintended adverse consequences (e.g. projects undermining government capacity by recruiting government officials). In terms of VfM of budget support, participants highlighted the need to ensure that the quality of services, rather than just their financial costs, remains a component in the VfM debate.

How to achieve effective budget support and **policy dialogue** was also raised as a key issue. Enzo Caputo noted that, in Tunisia, it was only the budget support donors that had high-level policy reform dialogue with the government. There was also evidence that it has led to the acceleration of reforms, sometimes because donors have been able to mobilise technical assistance to address key bottlenecks. But success is also clearly linked to the opportunity framework provided by the Association Agreement. In Mali, there has been effective dialogue in a range of sectors, but where preferences (across donors and governments) have diverged, policy dialogue have not secured the policy results it has aimed to achieve. Andrew Lawson suggested three things were necessary for successful policy dialogue: that donors 'push on open doors' (e.g. where preferences are already aligned); that those involved in policy dialogue have the necessary knowledge and experience to do so, as policy dialogue can be superficial in some instances; and that signalling should be clear and effective through the publication of targets, etc., which should incentivise action.

Finally, there were questions about the **ongoing monitoring of budget support** operations and how the effects of budget support compare with those of other modalities—analysis excluded from past evaluations. On the first issue, Andrew Lawson stressed the need for better and greater monitoring of budget support operations, suggesting the more effective and regular use of Public Expenditure Reviews (PERs). In response to the second issue, Enzo Caputo noted that, although the new evaluation methodology allows for an understanding of the complementarities between aid modalities, only the effects of budget support have been analysed.

There was a general appreciation that the new evaluation methodology has allowed the evaluation teams to be more confident about the contribution and attribution of budget support, thereby producing better evidence on how budget support can, as well as cannot, foster intended outcomes and impact.

4 The political economy of budget support: chair's summary

Chair: **Andy Norton**, Director of Research, ODI

Speakers: **David Booth**, Director of African Power and Politics Programme, ODI
Nadia Molenaers, Lecturer, University of Antwerp

The purpose of this second meeting was to examine the political economy of budget support from the perspectives of both recipient countries and donors. Discussion centred on the theory of change implicit in GBS and the institutional incentives, particularly on the part of donors, that influence the choice and nature of aid modalities. David Booth and Nadia Molenaers focused respectively on the political economy of recipient government and donor perspectives on GBS.

Presentations

David Booth reflected on evaluations of GBS to date, depicting them as torn between two competing purposes:

- The pull of GBS managers, who want to know what they have done right and wrong and how to fix it; and
- A commitment to political economy analysis, which focuses on understanding implicit theories of change and determining if these are in fact the appropriate theories underpinning GBS.

The tension between these two approaches to evaluation is ongoing, although the managerial approach appears to be winning out. This often limits or excludes an analysis of assumptions and implicit theories of change within evaluations, which are crucial in shaping GBS.

Earlier evaluations of programme aid, for instance, led to the realisation that donors cannot buy change through conditionalities. Rather, there must also be a drive and sense of ownership on the part of the recipient government. This realisation led to a shift in the modalities of development assistance, with a greater focus on budget support, given its ability to assist country systems in moving ahead, if the recipient government possesses the drive and the willingness to do so.

David Booth argued that it is inexcusable that evaluations of GBS to date have done so little to question whether the theories of change within it are accurate and evidence-based. Doing so is the most important task of evaluations and needs to be taken more seriously.

The table below demonstrates how a political economy approach can assist in developing a fuller understanding of the implications of the assumptions inherent within GBS (see Booth, 2011 for further channels).

The 'comment' column in the table below demonstrates that some of the assumptions in the GBS theory of change are not representative of evidence-based research in large parts of contemporary Africa. As a result, it must be questioned whether GBS along these lines is likely to lead to a reduction in poverty.

What can a political economy approach tell us about the assumptions of GBS?

Main channel	Assumption	Comment
'Partner government is empowered.'	'Political competition is moving away from patronage towards a focus on results.'	Some populist tendencies are visible in the best case (Ghana), but otherwise intensified competition is producing the theoretically expected result: intensified clientelism.
'Intra-government incentives and capacities are strengthened.'	'Government applies pay and performance assessment policies that contribute to incentives.'	This is happening in Rwanda, especially performance assessment (*imihigo*). It is a feature of 'developmental patrimonial' regimes, but otherwise a non-starter.
'Democratic accountability is enhanced.'	'There are domestic constituencies and pressures for higher standards of accountability.'	Sources of such pressure which are not funded by donors, and are therefore genuinely domestic, are rather few.

Source: Booth (2011).

Does this mean the GBS theory of change is wrong? If so, a better theory of change is needed, that reflects reality more accurately. Such theories will need to be country-specific, to reflect the different realities present.

Furthermore, if the theory of change is right after all, then this raises another challenge. Donors need to make decisions about GBS allocations on the basis of theory of change assumptions, rather than on the basis of other criteria, such as principles related to fundamental values (democracy, human rights, rule of law). It is the theory of change that should be at the centre of operational choices. Selection of GBS recipients to date has not been based strictly on GBS theory of change criteria, and therefore cannot be expected to be successful.

Finally, David Booth suggested that this debate needed to be taken into the public arena, so the public can be engaged in understanding how aid can be most effective.

Nadia Molenaers shifted the focus of discussion towards donor perspectives on GBS. She noted that, while donors have been keen to use political economy analysis in relation to understanding recipient government incentives, this should be used to understand donor incentives also.

Why is it, for instance, that experts favour GBS as an aid modality and yet donor governments are hesitant to use it? The neo-patrimonial institutions present in many African governments are problematic for donors, who must 'sell' their international aid programme to a public audience. Institutional reform of such governments is difficult, and requires significant trial and error. For these reasons, donors find it difficult to abandon project aid, which they have relied on heavily in the past and through which they maintain greater control.

Donors are politically led organisations that manage a division of staff (and incentives) between headquarters and field offices. Politicians operate on short timeframes and are sensitive to direct and visible results. Project aid provides more visible results than GBS, and often has greater resonance with politicians and their publics, despite also having negative impacts on the ownership and local legitimacy of recipient governments.

Aid also accommodates a variety of interests, including developmental, diplomatic, democratic and security imperatives. As a result, development assistance is frequently pulled in different directions because of its multitude of purposes and the resultant proliferation of deliverables.

Politicians (and, as a consequence, donors) are very sensitive to risk (especially reputational risk). Yet, GBS requires that donors be willing to take risks, as the needs that GBS seeks to address are long term and the results are incremental. This is not always an easy story to explain to public constituencies, and GBS advocates are therefore asking donors and politicians to take a risky leap of faith.

Donors assess prerequisite conditions for GBS readiness in different ways. These vary widely, especially in relation to the use of conditions as a part of bilateral aid. The conditions donors attach to GBS are often monitored closely, and a lack of progress in these areas can lead to GBS being cut. This reflects a heightened expectation on the part of donors as to what GBS can or should be able to achieve.

Donors are increasingly utilising a portfolio approach to aid as a risk-avoiding strategy. This has led to a proliferation of policy dialogues around each aid instrument within the portfolio, resulting in high transaction costs for both donors and recipient governments. It has also triggered an increase in strategic buy-in behaviour on the part of donors, who want to be a part of the dialogue in order to wield increased influence. The increasing use of different types of conditionalities in GBS means that recipient governments are required to meet technocratic *and* democratic goals.

In conclusion, the incentives of policymakers and donors are likely to remain in place, as are the governance challenges in Africa. This is likely to lead to a decreasing and more *ad hoc* use of GBS, with increasing conditionalities attached. This might be avoided if a division of modalities can be agreed whereby large donors take on the risk of GBS, leaving smaller donors to continue utilising more traditional aid modalities. It is also likely that donors will rely more frequently on SBS, as there is less risk attached to this than to GBS.

Discussion points

Significant debate arose on the issue of **theories of change** and how they impact on GBS configurations. It was pointed out that there is no universally agreed or shared theory of change within GBS, and that experience across donors varies greatly. Furthermore, the theory of change implicit in GBS must be more specific than the theory of change within aid more broadly, and this needs to be made clearer. A GBS-specific theory of change will need to factor in the concept that progress is rarely linear in practice and that the outputs and outcomes of GBS take different amounts of time to be achieved. One of the most crucial issues is that GBS is often expected to fulfil a multiplicity of needs within one instrument. Objectives are rarely prioritised, and their importance varies across stakeholder and time. Those involved in GBS operations should make their objectives and expectations clearer and, in some instances, less ambitious. In addition, they should establish a hierarchy of objectives for GBS operations.

Policy dialogue was raised as a crucial benefit of GBS, attracting donors who believe they can wield influence through this process. Such dialogue goes beyond simply GBS and opens up a whole range of related issues, such as governance, development and aid. However, some participants questioned the extent of donor influence within these settings. Many felt that the policy dialogue process of GBS had not been invested in sufficiently, and that the relationships built (which are meant to be longer term than in other aid modalities) were often weak. Furthermore, some donor representatives pointed out that referring to 'policy dialogue' as a singular process is problematic, as there is inevitably a range of voices, interests and channels within the dialogue that make it complex and multifaceted.

The role of **conditionalities** was also highlighted as a challenge in GBS. What, for instance, is the theory of change implicit within political conditionalities? That improved human rights will make aid more effective? Some suggested that there is little evidence to support such assertions, and that GBS should therefore focus more on its technocratic elements. However, it was also pointed out that political conditionality might be more about donors' home publics, rather than recipient governments. If so, while political conditionalities might not improve the results of aid, they may play an important role in making aid palatable to donor publics—a not unimportant factor.

Practical ways to improve the application of conditionalities were mentioned. These included making sure benchmarks and targets are evidenced and achievable; allowing for a forum of continuous dialogue; and ensuring there are mechanisms for high-level dialogue when things go 'off track'.

The relationship between **donors and their domestic constituencies** was an interesting theme of discussion, particularly in relation to how donors are limited by what they and their politicians can sell to the broader public. There was much discussion of the tensions between technocrats and politicians. It was suggested that the development community has largely sold aid to the public as project aid; now that the modalities have changed, public relations must catch up. The development community needs to start selling aid as long-term institution building, rather than quick wins—such as schools being built and children being vaccinated. It also needs to be bolder about budget support's successes and communicate the benefits more effectively.

The **decreasing use of GBS** was also discussed. This was attributed to several factors, including an increase in donor use of SBS, which is considered to contain less risk than GBS. Concerns were raised about what such a shift might mean for expectations of SBS—and whether the myriad purposes of GBS will simply be transferred to SBS, rendering it ineffective. The decreased use of GBS was also attributed to the increasing orientation of donor funds towards fragile states, where GBS is not considered an appropriate modality. As a response, it was put forward that new aid modalities might combine some characteristics of both budget support and project aid to address the concerns of both donors and recipient governments.

A palpable need emerged throughout the discussion for aid modalities that provide flexible aid that supports local ownership and systems, while still allowing donors to sell their aid to their home politicians and publics in a way that does not undermine the effectiveness of the instrument.

5 Budget support and fragile states: chair's summary

Chair: **Marcus Manuel**, Director of Budget Strengthening Initiative, ODI
Speakers: **Nicola Pontara**, Senior Economist, World Bank
Catherine Dom, Principal Consultant, Mokoro

The purpose of this third meeting was to examine budget support operations in fragile states—a group of countries that are a growing priority for many bilateral and multilateral donors. The meeting was an opportunity to showcase the World Bank/EU's Common Approach Paper (CAP) on budget aid in fragile states and recent analysis of budget support in such states. The discussion centred on improving risk management, strengthening political economy analysis and targeting budget aid towards the causes of and means to exit fragility.

Presentations

Nicola Pontara outlined the aims, main findings and recommendations of the World Bank/EU's CAP, its definition of fragile states and budget support and its implications for World Bank development policy lending (DPL) to fragile states.

The CAP is a tripartite initiative to analyse and improve budget support operations among the World Bank, the EC and the African Development Bank (AfDB).[5] The main objective is to strengthen coordination to improve the effectiveness of budget aid as a means to help countries make the transition from fragility to resilience.

The CAP starts from the premise that donors often exhibit five key characteristics in fragile states:

- They are risk-averse in their support.
- They tend to focus on short-term horizons with irregular flows of resources.
- Their policy content is overly standardised across very different countries (with limited variation for country context).
- Their political economy analysis is poor.
- They often take a technocratic approach that does not tackle the underlying causes of fragility, focusing instead on fiduciary risks.

Nicola Pontara explained how the CAP defines fragile states and budget aid, with the term 'budget aid' replacing 'budget support' because it encompasses all support to the budget (SBS, GBS, balance of payments support) and other modalities such as Multi-donor Trust Funds (MDTFs).

He then focused on six main findings and recommendations of the CAP:

- The rationale for budget support among the three donors is somewhat narrow in scope, often conceived of as a transfer of resources alongside technocratic PFM reform. The CAP recommends that future initiatives better articulate how budget support and other instruments can go beyond support to PFM reforms and address the causes of state fragility, while maintaining the need to prioritise.
- The predictability of budget support is low among the three donors, with operations characterised by single tranche (standalone) allocations and irregular disbursements. The CAP recommends a move towards a programmatic structure, with a mix of financing modalities where possible. There should also be a 'Plan B' in the event of non-compliance, precluding disengagement from the country by, for example, moving to different modalities with more robust safeguards, such as MDTF support.
- Budget aid operations overwhelmingly interpret risk as *fiduciary risk*, whereas there are multiple types of risks in such operations. Donors have different risk frameworks, with differing terms and concepts. The CAP recommends that donors develop common approaches to manage and pool risks, moving beyond fiduciary risk to include risks linked to politics and broader development and, very importantly, consider the risk of not engaging in the first place.

5 The International Monetary Fund (IMF) has also been actively engaged, given its important role in supporting macroeconomic stabilisation policies in the context of budget aid.

- Most prior actions in budget aid operations tend to look very similar across of range of different countries in terms of programme content, focusing on PFM, the public sector and economic governance. While these areas are important, there is scope to consider other areas critical to peace and state building, such as security, justice, jobs—all of these to be underpinned by political economy analysis.

- Results frameworks tend to overstate government capacity, have high tolerance for built-in programme failure and lack focus on peace and state building. The CAP recommends that donors gauge the contribution of budget aid to peace and state building while doing more to support these areas.

- There are varying modalities for donor coordination, including single versus multiple tranches and prior action versus outcomes. The CAP recommends the promotion of coordinated donor strategies of engagement based on non-legalistic, non-bureaucratic methods to strengthen working-level dialogue, an approach supported by recipient governments.

To conclude, Nicola Pontara summarised possible implications of the CAP on DPL within the World Bank, such as the need for a more realistic framework to measure results and more systematic consideration of a programmatic approach.

Catherine Dom presented the findings and issues emerging from a recent Oxfam Novib study on budget support in fragile states.[6] The study aimed to address broad questions on the provision of GBS (including whether to engage and, if so, on what terms) and to contribute towards an evidence base to help Oxfam Novib define its position on whether donors should consider budget support in fragile states.

She outlined the 'big ethical dilemma' that donors face, according to Oxfam Novib, when engaging with developing countries in general, and with budget support in particular: whether or not to give budget support when recipient government commitment to development is uncertain. Lack of commitment is often perceived, especially by constituencies in donor countries, as a more significant bottleneck than lack of capacity to the achievement of development outcomes. This makes it more difficult for donors to engage with budget support in the countries concerned.

In addressing this dilemma, donors need to consider carefully what recipient 'commitment' entails and how this might be measured. But in particular, they need to be clear why budget support would differ from other aid 'through the state' and, therefore, why it should be the only type of aid in which recipient commitment matters.

Catherine Dom explained that the authors of the study (but not Oxfam) had endorsed the OECD DAC perspective that budget support should not be more political than other types of aid. As such, donors that decide to engage with fragile states need to determine the particular value of budget support in fragile situations. The aim of budget support is always to empower the state, regardless of the theory of change. In a fragile environment, therefore, donors have to make a judgement about whether this is a desirable objective.

The study begins by providing an overview of current donor policies, practices and approaches on GBS in fragile states. It is clear from the analysis that donors in fragile environments have used a wide range of approaches, with often limited or absent policy frameworks. At the time of writing the study, for example, of the donors examined, only the EC had specific policy guidance for budget support in fragile states (see Handout 1 for more details).

The study then analyses GBS flows in fragile states (see Handout 2 for more details). Even accounting for data issues, GBS tends to be small in scale as a percentage of ODA in many fragile states. But in a handful of these countries, such as the Central African Republic, the Democratic Republic of Congo (DRC) and Sierra Leone, it is as large as it is in some of the highest GBS-recipient 'non-fragile' countries.[7] However, most non-fragile states have seen GBS increasing over the past decade, whereas GBS in fragile states has been very erratic, with no such upward trend. In addition, there is no correlation between the use/level of GBS and the fragility of the countries or their recent or long-term HDI trends.

The research includes case studies on Burundi, DRC and Ethiopia[8] (see Handout 3 for more details). The contribution of GBS is measured in three ways: by contribution to sector results; by contribution to PFM results; and by contribution to strengthening domestic accountability.

Examining DRC and Ethiopia, Catherine Dom demonstrated that DRC performed relatively poorly in all three areas, whereas Ethiopia performed relatively well. This reflects the very different objectives and designs of the GBS programmes in the two countries. In relation to sector outcomes, for example, Ethiopia's ongoing GBS operation has an explicit focus on service delivery and pro-poor/access government policies, which has contributed to this strong performance. This has not been the case in DRC, where GBS operations have focused on short-term macroeconomic stabilisation.

6 She emphasised that, while the study will be used to inform the development of Oxfam's position on budget support, the views represented within the study (and her presentation) were not those of Oxfam itself.

7 Based on total level of support between 2002 and 2009.

8 Catherine Dom's team carried out the DRC and Ethiopia case studies; the Burundi case study was carried out in-house by Oxfam.

Catherine Dom concluded by raising a number of issues, questions and suggestions for further discussion and to carry forward research, debate and practice:

- Whether donors should 're-label' budget support operations in fragile states (given the connotations of the label itself);
- The need to better distinguish the very different objectives that have underpinned GBS operations in fragile contexts;
- The need to tailor instruments—including GBS and others—according to the objectives;
- The importance of continuous assessment of the evolving risks in operations;
- The need for greater focus on demand- and supply-side accountability opportunities in GBS operations in fragile states.

Discussion points

There was a general consensus that donors should establish better **political economy analysis capacity**, which should be used to guide budget support operations. Such analysis should inform operational decisions, including whether or not to engage in budget support operations in the first place.

In relation to extending the focus of budget aid to address areas related to **justice, security and jobs**, it was suggested that job creation not be viewed exclusively as the responsibility of the private sector. Innovative approaches are required to address job creation and potential donor support in this area, particularly in relation to rural job creation.

Historically, GBS has not directly addressed issues such as security and job creation, focusing instead on the delivery of key basic services such as health and education. New modalities such as the World Bank's P4R may facilitate greater support to such areas and, in doing so, help to address the underlying causes of fragility.

Donors are **generally risk-averse and appear to be increasingly cautious about engaging** in budget support operations in fragile states. But not engaging in fragile states has its own considerable risks. There are also high potential payoffs from involvement in fragile states, and scope for many 'quick wins'. That said, participants had a sense that the aid community had been overly optimistic about what budget support can achieve, particularly in fragile environments, and that more realistic measures and results frameworks are required. Such frameworks need to take into account the probabilities of success and the recognition of 'good enough' governance.

The discussion also touched on **broadening the scope of risk analysis and frameworks**. It was felt that risk was often viewed from the perspective of the donor only, excluding a range of risks facing the partner country. In addition, it was suggested that most political risk analysis (including measuring the commitment of governments to service delivery) was very difficult and predominantly backward-looking. Incorporating a forward-looking approach will be challenging. In terms of responding to risks, it was suggested that using a more portfolio-based approach could address this in part, by allowing for flexibility to increase/reduce certain aid modalities within the portfolio to reflect changes in different types of risk.

The **rationale for different budget support operations** was discussed in relation to the discussion of risk. There was general consensus that factors beyond technical considerations (e.g. political factors) often influence decisions to assist fragile states through budget support.

Finally, in relation to the forthcoming Fourth High-level Forum on Aid Effectiveness in Busan, Korea, it was suggested that there **is a disconnect between the debate on general aid effectiveness discourse and the debate on fragile states**, even though fragile states receive a significant proportion of ODA.

The discussion concluded by noting that continuing to share different country experiences on budget support will enable the design of more effective instruments and the development of a more joined-up agenda on fragile states.

6 Budget support and budget certification—Is it the way forward?: chair's summary

Chair: **Alison Evans**, Director of ODI

Speakers: **Paul Collier**, Director, Centre for the Study of African Economies, Oxford University
Mick Foster, Senior Research Associate, ODI
Marcus Manuel, Director of the Budget Strengthening Initiative, ODI

This purpose of this meeting was to discuss the proposed use of an international budget certification system in the context of giving aid through budget support. The discussion centred on the rationale and form of the budget certification system, how it works in practice and other options to address similar challenges.

Presentations

Paul Collier formally presented for the first time his ideas on establishing an international budget certification system for budget support operations. He first spoke about the problem with the current approach to aid; why a certification system was necessary; and how it would work in practice and what it would mean for the various actors in the aid relationship.

In his opinion, the use of aid has been long on policy objectives but short on the use of instruments to deliver these. The instrument donors have typically used in the aid relationship is to vary the volume of aid, that is, how much aid to give. This is flawed under the Tinbergen rule, according to which donors need as many aid instruments as they have objectives. As a result, donor policy has lurched between different objectives in a 'fidgety way, re-prioritising whatever donors think is being neglected'.

Aid objectives can be streamlined, but in Paul Collier's perspective not beyond two key ones—those of *need and effectiveness*. To achieve these objectives requires the use of at least two different instruments: the volume of aid *and* the modality through which it is provided. Crudely, how much aid to give can be linked to the objective of aid, and how effective this aid is can be linked to the modality used. The key variable to define which modality is used should be the recipient country's governance conditions. At present, donors vary the volume of aid according to the quality of governance conditions, but in Paul Collier's opinion this needs to be rethought.

In his opinion, in countries with better governance conditions, budget support is the best modality and the government the best agent, as it has the best information on where funds should go and is accountable to its people. In badly governed environments, however, 'life support', not budget support, is needed. These are environments where two fundamental conditions are not met. First, *the partner government does not have the right intentions*. To assess whether governments are 'benign' and working for the benefit of their citizens is a political judgement donors need to make as part of the aid relationship. Second, *the partner government does not have the right capacity*. In Paul Collier's opinion, we do not currently have an 'honest process' for assessing whether government systems are of the right standard. An analysis is necessary not of the capacity of the political elite in government but rather of the channels through which money needs to pass. Government may not have adequate capacity where public spending is 'leaky' and where the civil service is unable to deliver government intentions, because of either incompetence or corruption.

His proposal is to have an *international certification system* which will certify countries as 'fit' or 'not fit' to receive budget support. An Independent Certifier (IC) will have to satisfy itself that the money passing through the budget process could not be misappropriated and the system is as robust as an OECD country system to be able to withstand different political pressures. If a country failed the certification process, a notice would be served, with the potential for recertification after three years. During the interim period, the country would be allocated support to build its capacity. If the country failed again, the donor would have to change the modality it used, although the volume of aid would remain constant.

Why would such a system be to the advantage of a *recipient country*? Certification can help empower domestic reformers to change their PFM systems and limit leakage, which not only weakens the delivery of public services but also sees the captured funds used to purchase political patronage. From the point of view of *taxpayers in donor countries*, certification can send a strong signal that there is a zero tolerance to corruption within aid processes. *Donor agencies* will need to move away from the status quo and provide aid through other transitional arrangements if recipient countries do not pass the certification process. The *certifying body* will need additional diagnostic instruments than those already available, and will need to sign off on its assessment to be able to send strong signals regarding the state of domestic PFM systems.

In his presentation, **Mick Foster** questioned whether certification was necessary and how it would work in practice. His contention was that aid, especially the volumes promised under the Millennium Development Goals (MDGs), cannot be delivered as effectively through any other aid modality than budget support. He made the point that the term ‘budget support’ actually refers to a spectrum of aid modalities that use government systems, ranging from GBS to SBS.

He agreed with Paul Collier that the problem of weak PFM systems needs to be dealt with, but in his opinion any aid modality that bypasses the government has serious short- and long-term consequences. If necessary, donors could use additional mechanisms to help manage the risks associated with using specific country systems, such as introducing more intrusive fiduciary safeguards, for example procurement audits, replenishment schemes, earmarking and community accountability, as well as ensuring improved transparency of systems and aid data. He felt that budget support helped to give donors an invitation to dialogue with recipient governments on weak PFM systems and their poverty reduction objectives. Furthermore, budget support operations are often instrumental in strengthening such systems.

Mick Foster also had questions around how a certification process would operate in practice. He made the point that any PFM system has a degree of non-compliance and ‘leakage’, including that of the UK. It is therefore difficult to establish what criterion a certification process would use and how rigid it would be. Related to this is the question of which institution could act as an IC. The assessments that the IMF currently performs, like Report on Observance of Standards and Codes (ROSCs) and Public Expenditure and Financial Accountability (PEFAs), do not provide the detail needed for certification. Procurement audits and Public Expenditure Tracking Surveys (PETSs) would be required. Alternatively, if private accountancy firms are used, the reputational risk to these firms could make them set certification standards artificially high. Monitoring would also have to be constant, since improvements in PFM systems are a ‘process not a destination.’

Marcus Manuel made additional comments on the certification proposal. He strongly agreed with Paul Collier on the need to respond to the perceptions of taxpayers in donor countries, and therefore to revisit the way budget support is currently managed. He also agreed that improvements in PFM systems are necessary. Even though a great deal of money is being spent to improve these systems, analysis of PEFA scores suggests that, across countries, progress has been modest. For example, although a quarter of African Heavily Indebted Poor Countries (HIPCs) have shown an improvement, half have shown no significant change and a quarter have demonstrated a deterioration in their performance.

Marcus Manuel could see two problems with using certification in practice. First, there would be a time inconsistency problem, whereby donors may not be comfortable providing aid through budget support in the interim period when a country is developing its capacity. Instead, donors might insist that no budget support be given until actions have been taken. He also felt that certification could become something of a ‘holy grail’, that the standards required to introduce budget support could be so high that they would be unattainable.

From his point of view, an important step in the right direction would be to increase transparency in assessments of PFM systems, for instance by publishing PEFA scores and through the Open Budget Index. Moreover, he considered that, if recipient countries score badly on different existing assessments, then they will need to accept a greater level of intrusion from donors in terms of how they manage their public finances. For instance, a range of instruments, like the Afghanistan Reconstruction Trust Fund, have been used and are currently in use by donors that are more intrusive (e.g. in terms of auditing) but provide donors with the additional assurance they need.

Discussion points

The discussion focussed on four main areas. The first related to **clarifying the proposal**. As this was the first time ideas on the certification process had been widely presented, much of the discussion focused on clarifying what everyone understood by the terms being made in the proposal. Some participants made the point that weaknesses in public expenditure systems in developing countries were not in PFM systems but in the *compliance with* those systems. A certification process would need to measure compliance with the system and then to set some acceptable threshold, as even in OECD countries 100% compliance is not achievable. This compliance would be with the system and not with the composition of spending or the policy choices that the government makes. Paul Collier was firm that certification was not about policy conditionality but rather about enforcing good standards of governance. It was noted that measuring compliance is not a straightforward task.

Much discussion took place around the alternative modalities donors would have to use in countries that did not pass the certification process. An assumption made by Mick Foster and other participants was that, when countries do not pass the certification test, donors will use project aid instead. Paul Collier clarified that his suggestion was not that project aid be used in countries not eligible for 'pure' budget support. This clarification reduced the differences in views about certification among participants. However, a point was made that, although certification may not have the intention of increasing project aid, donors may in fact see projects as the obvious alternative to budget support.

The second area of discussion related to the **additionality of certification**: whether certification is in fact necessary, given the range of other diagnostic instruments that analyse country systems, such as PETSs, procurement audits, ROSCs and, in particular, PEFAs. There was some discussion on the limited value of PEFAs, as these are published only if the recipient government chooses to do so, are published with a lag and are, for many donors, not used formally to determine whether countries will receive budget support. For these and other reasons, PEFAs do not lead to better PFM performance. Certification would then be distinct from PEFAs, as it would measure compliance with systems, not just systems themselves. Its greatest value would be in sending a strong signal that a particular PFM system is not up to standard.

The third area related to **how certification would work in practice**. There was a concern about *data scarcity*. Any process to measure compliance with a public expenditure system would require in-depth work and primary data that are difficult to obtain in developing countries. The *time inconsistency problem* with certification was discussed again. Paul Collier's suggestion was that countries that fail to certify should be given three years to improve their systems before budget support is suspended. However, participants felt that politicians in donor countries would find it difficult to provide budget support in the interim years between certification and recertification. It would be difficult to explain to taxpayers in donor countries why country systems were being used to channel aid when these had failed to certify. There was a largely held view among participants that a pass/fail certifications system would not work and that a rating and ranking of some sort would be required.

Finally, a large part of the discussion focussed on **whether certification would actually achieve** its various objectives, including that of better PFM systems. Certification could have an impact on the incentives of line ministries to improve PFM systems. This is because line ministries traditionally often resist the introduction of budget support if it diverts aid coming directly to the sector to the general budget. If donors made the provision of budget support conditional on the performance of PFM systems, line ministries could resist pressure from ministries of finance to improve their management of funds.

Others felt that if the ultimate aim of aid is to improve domestic revenue (such that aid is no longer required), then *taxpayers in developing countries* need to have sufficient trust in their own public expenditure systems. Certification could help to make this transparent and also to transfer good practices across countries. An opposing point of view was that certification would not work as a signal for recipient societies as long as aid continues to flow from donors to government systems. The domestic audience does not care about the modality being used but sees any type of aid flowing between donors and governments as complicity.

Similarly, many participants did not think that certification would improve the trust of taxpayers *in donor countries* in aid processes, as they do not know or care about aid modality *per se* but rather are concerned about any aid being given to a country that does not make the right spending choices (the favourite example used was that of purchasing a presidential jet). It was suggested that tax payers are concerned more fundamentally with values and human rights issues in recipient countries, rather than whether aid is being used efficiently.

Participants also did not think that certification would help with the broader aims of budget support, specifically those related to *growth, poverty reduction and improving service delivery*. Certification would make donor choice discrete in an environment that is actually quite complex, and such a focus may draw attention away from addressing the real bottlenecks that limit the achievement of such objectives. Similarly, dislodging the political capture of leaked funds is a long-term, complex issue that cannot be tackled by certification alone and may not be tackled in a three-year window.

In the end, whether certification will work may be less about weaknesses in the process and more about it not being seen as a *credible process*. As donors do not always live up to their promises, recipient countries may not improve their systems because they do not believe that donors will actually deliver aid, even if they do pass the certification process. This is to do with a larger discussion on donor incentives and assumptions made about 'benign donors'.

7 Results and innovative approaches: chair's summary

Chair: **Edward Hedger**, Head of Centre for Aid and Public Expenditure, ODI
Speakers: **Jonathan Beynon**, Senior Policy Advisor, EuropeAid
Fadia Saadah, Investment Policy Group Manager, World Bank
William Savedoff, Senior Research Fellow, Center for Global Development

The purpose of this fifth and final meeting was to explore new and innovate results-based aid mechanisms that either are budget support or share common features with it: the EC's Variable Tranches and MDG Contracts, the World Bank's proposed P4R and the CGD's COD proposal. The discussion covered issues related to the implementation capacity of recipient countries, measuring and demonstrating results, preferences for results-based aid and the complementarities between it and other aid instruments.

Presentations

Jonathan Beynon discussed two EC budget support modalities: the budget support Variable Tranche and the MDG Contract. He explained that the EC's budget support allocation has increased in recent years and currently accounts for roughly a quarter of its aid disbursements. EC budget support programmes tend to combine a fixed tranche (~60%) conditional on general eligibility criteria, and a variable tranche (~40%) that will vary in size depending on the recipient government's performance against a set of indicators. This combination of fixed and variable tranches aims to ensure sufficient funding predictability while setting incentives for good performance. A review of budget support under EDF 9 found that the average disbursement rate for the variable tranches was 66% and tended to hover between 60% and 70%. Most of the performance indicators focus on public sector reform and PFM, health and education. The analysis found no major difference in performance against outcome and impact indicators versus input and output indicators, despite less direct government control over impact. There is also no difference in performance across sectors. Over a longer (three-year) time horizon, there is some indication that indicators weighted more heavily in the variable tranche perform better, which may suggest that governments are responding to the variable tranche incentives.

Jonathan Beynon also described the EC MDG Contracts, a longer-term budget support arrangement aimed at high-performing countries, whereby disbursements are again linked partly to performance against MDG-related targets. Some anecdotal findings suggest that MDG performance is strong in a number of target countries, but an evaluation of the programme has not yet been undertaken.

He concluded that these budget support modalities have allowed for more flexibility, but stressed that the effectiveness of the instruments depends greatly on the quality of the dialogue in-country. Furthermore, as one aid instrument among many, the EC's instrument may not have the critical mass to act as a performance incentive. He underlined the need for further research and analysis of budget support effectiveness.

Fadia Saadah presented the World Bank's P4R, a new financing instrument that will shortly be presented before the World Bank Board for approval. She explained that this proposed new instrument will be used to finance government programmes using the programme's systems, with disbursements linked to results rather than inputs. It has been designed in response to demand from recipient countries for an alternative to the Bank's other lending instruments—project/investment lending and DPL.

Key features of the P4R instrument include:

- Financing is for a government programme (e.g. a specific sector, subsector, national or sub-national programme).
- Disbursements are made when a set of agreed results are achieved.
- Funding is matched with capacity-building support that will help the government to achieve the desired results.
- The Bank reviews the implementation structures and assures that financing is used appropriately and environmental and social impacts are addressed adequately.

Fadia Saadah stressed that rigorous assessments of fiduciary, social and environmental aspects, all important values for the Bank, are required before a decision on providing P4R support is made. In practice, the Bank will first review the programme for which P4R financing is being sought and its various technical dimensions (including strategy, expenditures and results), as well as fiduciary, environmental and social issues. In each area, the assessment will examine risks, capacity and performance. Moreover, certain activities are excluded from the instrument, including activities with high environmental or social risks (Category A projects in Investment Lending) and large procurement contracts above a specific threshold.

The P4R Concept Paper has undergone extensive consultation. The Policy Paper, which takes into account the feedback received on the Concept Paper, is available on the World Bank website. Existing projects expected to make use of this facility include a mix of International Development Association (IDA) and International Bank for Reconstruction and Development (IBRD) projects and cover a wide range of sectors.

William Savedoff presented a proposal developed by CGD for COD aid. He stressed that this initiative responded to concerns over the deficiencies of traditional development approaches, which are seen as cumbersome, invasive and prescriptive. He argued that these are the same concerns as those with traditional project aid that led donors to try GBS. COD aid would rely more fully on recipient countries to develop their own strategies and be responsible for implementation by basing payments solely on results. This approach requires donors to remain hands-off, with the recipient country given full responsibility for the delivery of results.

He argued that paying for outcomes would increase accountability in both funding and recipient countries. Taxpayers in donor countries will be able to see the relationship between their financing and the results it achieves, whereas citizens in recipient countries will be able to monitor their government's performance more easily.

COD has five key features:

- Payments are in proportion to outcomes (e.g. number of primary school leavers), rather than linked to meeting a specific target (which should lower the stakes of meeting a specific target).
- The recipient sets the strategy (with funders involved only to the extent that the recipient requests their assistance).
- Results are verified independently.
- Results are disseminated publically and are easy for both the recipient and the funder to explain to their respective constituents.
- COD would complement, not replace, other funding modalities.

COD shares many features with budget support, notably the use of country systems and a focus on performance. Where it differs is in its focus on only one or very few indicators, its emphasis on independent verification and a clearer relationship between payments and outcomes. William Savedoff also suggested ways to make budget support more effective by moving towards COD aid principles. He recommended reducing the number of indicators, disbursing against continuous results rather setting specific targets and allocating resources to independent verification of data collected on outcomes.

Discussion points

Participants discussed the effectiveness of the three results-based aid modalities, focusing on capacity constraints, VfM, measurement issues, risks and complementarity with other aid instruments.

Participants discussed the requisite **implementation capacity** to achieve the desired results, and whether the proposed aid modalities would be effective in countries with weak capacity. The EC Variable Tranche and the World Bank P4R provide capacity-building support alongside incentives for results. It was clarified that, in weak implementation environments, the P4R disbursement indicators can focus on process issues such as institutional capacity, rather than on outcomes. COD aid, in contrast, questions whether donors know how to build capacity and proposes that results payments may be a more effective approach, since these reward recipient governments for learning by doing. COD aid proposes that recipient countries be given the space to experiment and develop implementation systems appropriate to the local context.

Some participants stressed the importance of assessing **VfM** in results-based aid mechanisms, whereas others felt it was very difficult to assess the VfM of aid projects, given limited data on outcomes.

Participants discussed the **challenges of measuring and managing for results**. Concerns were raised about the ability of independent agencies to verify results, given the paucity of reliable data in developing countries and the incentives to distort the truth. Results-based aid will need to strike a balance between setting incentives that are strong enough to encourage good performance, but not so strong as to encourage data distortion. It was questioned whether the COD aid focus on only one indicator is appropriate, as a larger number of indicators would allow for cross-verification. Participants also discussed the difficulty of selecting appropriate indicators, as donors tend to favour indicators that are easy to measure over ones that are relevant. It was noted that CGD's book about COD aid describes methods for selecting appropriate indicators and shows how most concerns can be addressed when it is applied to particular goals and contexts. It also stresses the importance of selecting relevant indicators focused on outcomes rather than inputs, indicators that are responsive to government policies (thereby limiting variability owing to exogenous factors) and indicators that do not run the risk of distorting public spending patterns and sectoral activities—another concern raised by participants.

The discussion also focused on **complementarity between results-based aid and other aid** instruments and the appropriate mix of aid modalities. While all three speakers stressed that their instruments would complement rather than replace other modalities, it was noted during the discussion that, given the current global economic crisis and the shrinking aid envelope, new aid instruments are likely to reduce financing through traditional instruments. Participants noted that donors do value the broader policy dialogue that GBS affords them. They felt there was a trade-off between budget support and results-based project aid. While results-based aid mechanisms such as COD aid and P4R deliver clearer results, they do not provide the 'all of government' approach that GBS offers. Results-based aid needs to achieve some scale in order to incentivise performance, and this could have distortionary effects on public spending. COD aid and P4R may focus government attention on one narrow outcome at the expense of overall government performance. There were also concerns that COD aid and P4R might undermine the aid harmonisation[9] and alignment agenda by placing emphasis on individual programmes rather than channelling support towards a broader development strategy, risking the development of 'orphan sectors'. Participants also questioned whether results-based aid could support accountability and transparency reforms.

In reference to the EC's Variable Tranche, the discussion touched on the appropriate modalities for donor budget support coordination. Should donors select reinforcing performance indicators, or try to harness comparative advantages by channelling their support towards different sectors? It was suggested that the EC's Variable Tranche and MDG Contracts should disburse against continuous results rather than specific targets so as to foster better incentives for performance.

The discussion also considered the appetite for results-based aid modalities from the **perspectives of both recipient and donor governments**. It is not clear whether recipient governments would prefer results-based project aid over budget support. There were differing views on this: some suggested that recipient governments may favour performance indicators that they have greater control over achieving (e.g. indicators towards the inputs end of the results chain); others suggested that governments are likely to prefer the achievement of results rather than process improvements. In addition, donor enthusiasm for GBS is waning. Participants from donor agencies expressed an interest in narrower aid mechanisms where results attribution is clearer. A fundamental concern for donors is the perceived trade-off between a focus on results and the need for a general policy and political dialogue. Some participants felt that these two goals can never be entirely delinked in aid.

Concluding remarks and way forward

The chair concluded by summarising some important themes emerging from the budget support meeting series that ODI hopes to take forward. He discussed the shift away from a strict dichotomy between project and budget support towards a broader menu of aid modalities; efforts to consider and address risks in a multifaceted way; country perceptions of budget support and preferred aid modalities; and political economy considerations and how they can be woven into the budget support debate.

9 Although they may be used as ways to start to improve the harmonisation of donor support in a sector, a point made by Fadia Saadah.

8 The emerging research agenda

Following the meeting series, ODI identified several specific topics for research to improve the range of policy options for delivering aid at the country level. This research would produce a range of research papers, frameworks and tool kits.

Establishing a new taxonomy of existing and emerging aid instruments

Develop an up-to-date comprehensive classification of the features of aid instruments. This will include the spectrum of aid instruments that exist, accounting for both conventional and new hybrid forms.

Understanding recipient country perceptions of effective aid delivery

Examine the features of aid delivery that recipient countries find most positively supportive of their service delivery objectives. Explore which features of aid instruments and portfolios partner country stakeholders think best address service delivery bottlenecks to generate a better knowledge base on the features of aid instruments that best facilitate development impact.

Designing portfolios of complementary aid instruments

Explore how donors, either individually at country level or collectively at a programmatic/sector level, can design aid portfolios that maximise the complementary effects of different aid instruments.

Embedding political economy analysis in aid instrument design

Examine the incentives and constraints facing donor and partner governments when designing and implementing aid operations. Provide improved guidance on how to account for such realities more effectively, to inform a more realistic and feasible set of policy options.

Comparing the efficiency of different aid instruments

Assess the efficiency of budget support as compared with other aid instruments, by estimating and comparing the unit costs of goods and services provided through project aid and budget support. This would consider factors such as the cost of leakage owing to relatively weak country systems against the margins made by external service providers.

Designing better options for aid delivery

Bringing together the findings and conclusions from the other research topics, develop a new fit-for-purpose framework for designing and implementing aid instruments at the country level. This will aim to account more effectively for multidimensional risks, political economy factors and the achievement of development impact. It will provide policy options for aid delivery by suggesting a range of hybrid models which can be applied based on country circumstances.

9 Consortium of experts and participants[10]

Richard Allen	ODI
Joanne Asquith	AFDB
Stephen Akroyd	OPML
Richard Batley	University of Birmingham
Brucie Beyiers	ECDPM
Joanthan Beynon	EC
Neil Bird	ODI
David Booth	ODI
John Burton	KPMG
Enzo Caputo	DRN Network
Francisco Ceneiro	World Bank
Jean-Louis Chomel	EC
Paul Collier	CSAE, Oxford University Centre
Marcus Cox	Agulhas
Paolo Craviolatti	DFID
Antonie de Kemp	Ministry of Foreign Affairs, the Netherlands
Lisa Denney	ODI
Catherine Dom	Mokoro
James Donovan	Sida
Alison Evans	ODI
Jörg Faust	DIE
Mick Foster	ODI
Richard Gerster	Gerster Consulting
Jonathan Glennie	ODI
Helen Haile	GIZ
Rachel Hayman	University of Edinburgh
Edward Hedger	ODI
Joana Henseler	GIZ
Anna Holmryd	Ministry for Foreign Affairs, Sweden
David Hoole	OPM
Michael Hubbard	University of Birmingham
Alessia Isopi	University of Nottingham
Phil Johnston	DFID
Stephen Jones	OPM
Thomas Juel Thomsen	Ministry of Foreign Affairs, Denmark
Linda Kalimba	Rwanda High Commission
Megan Kennedy-Chouane	OECD
Maia King	ODI
Svea Koch	DIE
Andrew Lawson	Fiscus
Michel Lazare	IMF
Stefan Leiderer	DIE
Stephen Lister	Mokoro
Christiane Loquai	ECDPM
Hans Lundgren	OECD
Marcus Manuel	ODI
Nicoletta Merlo	EC
Nadia Molenaers	University of Antwerp
Sam Moon	ODI
Edward Mountfield	World Bank
Alexandra Murray-Zmijewski	OPML
Andy Norton	ODI
Katrin Ochsenbein	SECO
Sven Olander	Sida
Elisabeth Paul	University of Liege
Birgit Pickel	BMZ
Nicola Pontara	World Bank
Helen Radeke	GIZ
Isabelle Ramdoo	ECDPM
Andrew Rogerson	ODI
Frans Ronsholt	World Bank
Gunter Roos	BMZ
Monica Rubiolo	SECO
Ernest Rwamucyo	Rwanda High Commission
Fadia Saadah	World Bank
William Savedoff	CGD
Stephen Sharples	DFID
Rebecca Simson	ODI
Phil Sinnett	World Bank
Greg Smith	Crown Agents
Wolfgang Solzbacher	KfW
Susanne Spets	Sida
Carolin Stetter	KfW
Heidi Tavakoli	ODI
Paul Thornton	Verulam Associates
Carew Treffgarne	DFID
Martin van der Linde	ECORYS
Hyman van Praag	Ministry of Foreign Affairs, the Netherlands
Jan Vanheukelom	ECDPM
Sanjay Vani	World Bank
Paul Walters	DFID
Helen Wedgewood	DFID
Asbjorn Wee	OECD
Frank Weiler	KfW
Leni Wild	ODI

10 Some participants may be excluded if they did not register for the meeting in advance.

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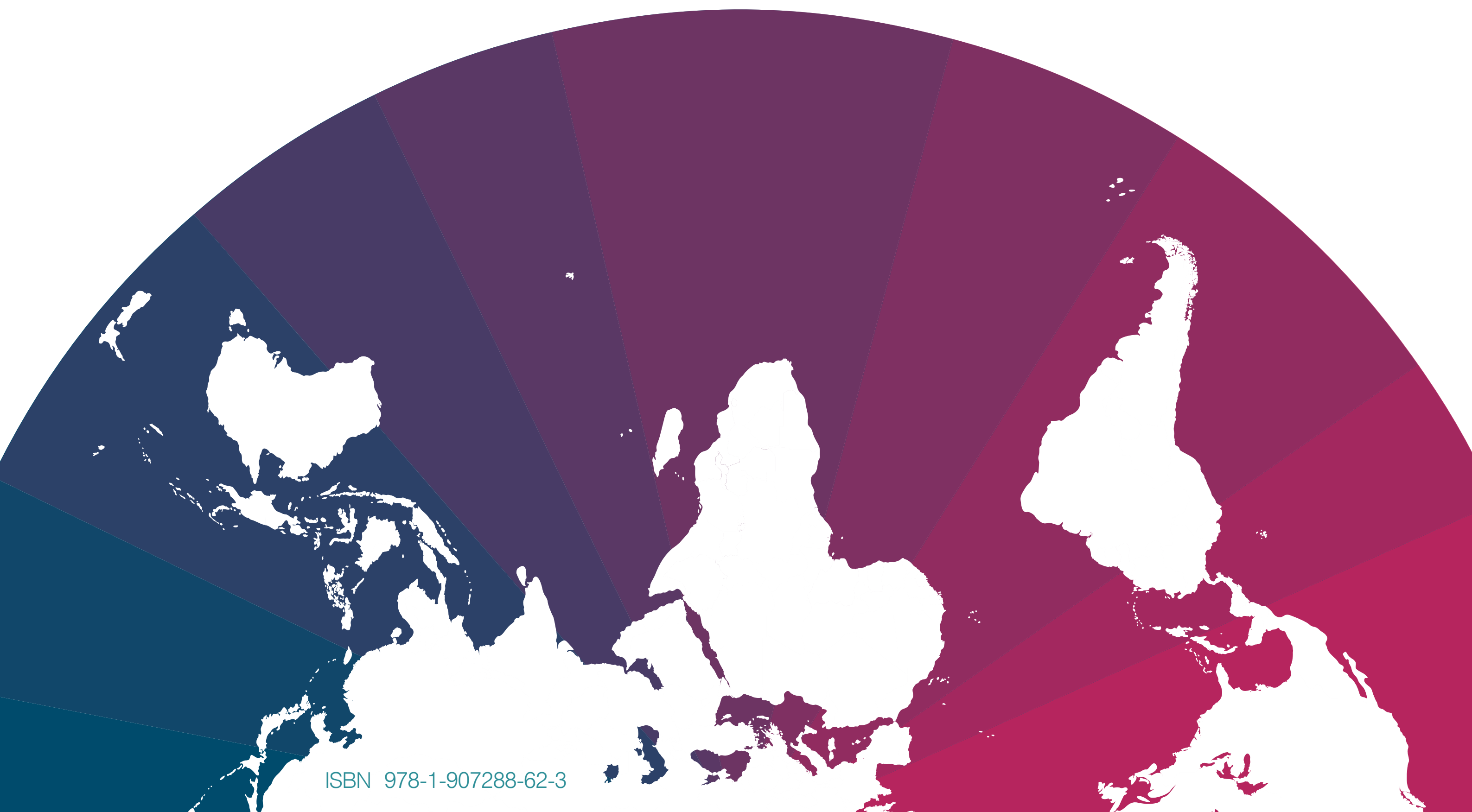
Centre for Aid and Public Expenditure
Overseas Development Institute
111 Westminster Bridge Road
London, SE1 7JD

c.admin@odi.org.uk

www.odi.org.uk/cape



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