

**ACP/81/032/11**  
MDFIP/BL/mjn  
*Tr:GW/ Rev:AM*

**Brussels, 21 March 2011**

**BUDGET SUPPORT IN ACP COUNTRIES  
UNDER THE 10<sup>th</sup> EUROPEAN DEVELOPMENT FUND (EDF)**

## Introduction

1. The commitments to increase Official Development Aid (made at Monterrey in 2002, Gleneagles in 2005, and Doha in 2008) with the aim of increasing development financing in developing countries, and achieving the Millennium Development Goals (MDGs), have given rise to increasing international debate on aid effectiveness, and particularly on the best way of delivering aid to partner countries.
2. In the Paris Declaration (2005), donors adopted the resolution to, among other things, "*reform the way they delivered and managed aid*" so as to make it more effective, by increasing the amount of aid delivered through national systems. The Accra Agenda for Action (2008) went even further by stipulating that the use of partner countries' systems should constitute, in the future, the first-line solution for the delivery of aid, and that, if it were not, the donors should explain why it was not used.
3. The European Consensus on Development (2006) specifies that "*the use of general or sector budget support should increase as a means to strengthen ownership, support partners' national accountability and procedures, finance national poverty reduction strategies, and promote sound and transparent management of public finances*".
4. The Cotonou Agreement (2000) refers to budget support as a modality of implementing EDF aid in ACP countries. Annex IV (Art. 4a) stipulates that "*the draft indicative programme shall contain general budget support and/or a limited number of sectors or areas on which aid should be concentrated*", and provides for (Art. 19c.2) the use of national procedures in accordance with the Paris Declaration.
5. Ultimately, the debate on aid effectiveness has resulted in promoting budget support as the most appropriate aid delivery modality, given the current development context in the partner countries. The European Commission (EC), as well as many other donors, is increasingly adopting budget support with the aim of making their aid more effective and better tailored to current needs.
6. In the light of the increasing volume of aid, changes in the nature of requirements (public policy reforms, financing of MDGs, strengthening of governments' capacities), and the emergence of new development challenges (climate change), project aid—which is often fragmented and carries high transaction costs—seems increasingly ill-adapted as a mode of delivering aid.
7. In its implementation, however, budget aid has sparked controversy. Certain stakeholders within the European Union (the European Parliament, civil society, the European Court of Auditors) regularly express sharp criticism of the EC's management of budget support in ACP countries.

8. It was in this context of change and criticism that the EC, in 2010, launched a public consultation on the future of budget support through the publication of a Green Paper on European Union (EU) budget support.
9. This note reviews, first of all, how budget support has evolved under the 10<sup>th</sup> EDF. Secondly, it examines the controversies surrounding budget support, and thirdly, it takes a look at the future of EU budget support.

## **1. European Commission budget support: trends and volume**

10. The EU has been providing budget support to the ACP countries since the 7<sup>th</sup> European Development Fund (1990-1995). However, structured, widespread use of EU budget support began with the 9<sup>th</sup> EDF (2001-2007).
11. While budget support accounted for 30% of programmable funds under the 9<sup>th</sup> EDF (General Budget Support (GBS): 21%; Sector Budget Support (SBS): 9%), under the 10<sup>th</sup> EDF it is expected to account for nearly 50% of programmable funds (GBS: 31%; SBS: 17%). Many ACP countries receive a significant proportion of European Union aid in the form of budget support. According to the EC, approximately two-thirds of the ACP countries receive EU aid in the form of budget support.
12. In the Asian and Latin American regions, the volume of aid delivered in the form of budget support is also on the rise, increasing from 12% for the period 2003-2005 to 25% for the period 2006-2009.
13. In all, from 2003 to 2009, the EC's commitments in terms of budget support amounted to more than EUR 13 billion, i.e., approximately 25% of its total commitments for the period in question. About 56% of the allocated amounts was intended for ACP countries (excluding South Africa), 24% for countries targeted by the European Neighbourhood Policy, 8% for Asia, 6% for Latin America, and 5% for South Africa.
14. The proportion of aid allocated as budget support through the European Union's various financing instruments is steadily increasing, and is becoming its main aid delivery modality.
15. The EC, like many other donors, tends to favour budget support, whether General Budget Support or Sector Budget Support, which it considers the most effective means of delivering aid to developing countries. This aid-delivery modality is the mechanism which is best suited to fulfil the commitments of the Paris Declaration, and as such, contributes to improving aid effectiveness.
  - By transferring resources to the national budget to support the financing of a national or sectoral poverty-reduction strategy, and economic and social reforms formulated by the partner country, budget aid ensures consistency with the partner country's choices and priorities. As such, it contributes to reinforcing ownership and political accountability, and

fosters the strengthening of governments' capacities. It is also an effective response to the issue of aid harmonisation since donors are aware that their aid is managed through the partner country's budget, and do not need to set up parallel management units.

- The use of budget-aid resources in line with the partner country's systems and procedures contributes to strengthening national systems, and particularly the public-finance management system. It also responds to concerns relating to aid alignment in that donors no longer need to impose their own procedures.
- The multi-annual approach to budget support helps to ensure greater predictability and stability of aid resources, and facilitates medium-term financial planning and programming of development projects and programmes.
- By linking the disbursement of variable tranches to the achievement of an agreed matrix of results, budget aid is consistent with a results-based management approach. It facilitates dealing with the issue of conditionality, which is often a bone of contention between donor and recipient. It is not that conditionality has been abandoned altogether. It has changed in nature, i.e., it has shifted from being instruments-based to results-based.

## **2. Criticisms by the European Court of Auditors of budget support: risk and effectiveness at the heart of the debate**

16. Despite its international framework, its relevance and its comparative advantages, budget support, in its implementation, has attracted criticism. Certain stakeholders, particularly the European Court of Auditors, have been raising an increasing number of questions on the quality, cost effectiveness and impact of budget support.

17. In its special report No.11/2010, as in other earlier reports, the European Court of Auditors criticised the European Commission's management of General Budget Support.

18. The Court's report made the following observations:

- i. Inadequate adaptation of the objectives of budget support programmes to the specific conditions of the individual countries;
- ii. Poor management of the main risks to the effectiveness of budget support;
- iii. No guarantee for optimising the potential impact of the budget support programmes due to their design and implementation;
- iv. Highlighting of the potential benefits of budget support rather than the results.

19. On the basis of these observations, the Court made the following recommendations to the Commission:

- i. Better adapt the objectives of budget support programmes to the specific conditions of the partner country;
- ii. Strengthen risk management to better protect EU funds against loss, wastage and ineffectiveness;
- iii. Determine the amounts to allocate to individual general budget support programmes in a more detailed and transparent manner;
- iv. Focus capacity-building aid on the partner country's priority needs;
- v. Reinforce management of performance-related conditions;
- vi. Improve the approach in terms of dialogue;
- vii. Improve procedures for establishing reports on the effectiveness of general budget aid programmes.

20. It should be pointed out that the criticisms expressed by the Court of Auditors do not call into question the legitimacy of budget support as an aid-delivery modality. Instead, they seek to remedy the deficiencies observed in its implementation which prevent budget support from achieving its full potential and effectiveness.

21. Despite the relevance of the Court's criticisms, budget support is, however, not a blank cheque to partner countries. Respect for the legal framework, performance conditionality, and the policy dialogue that underpin budget support are safeguards against dysfunctions, and significantly minimize the fiduciary risk so often mentioned.

### **3. Towards a reform of the European Union's budget support policy**

22. On 19 October 2010, the EC published, for the attention of the European institutions, a Green Paper on the future of EU budget support to third countries. At the same time, and on the basis of that Green Paper, it also launched a public consultation on budget support.

23. According to the EC, the aim of the public consultation, based on the Green Paper, was two-fold:

- to gather the views of the various stakeholders with the aim of improving the EU's budget support policy to make it more effective as an aid-delivery modality;

- to take account of criticisms expressed by European civil-society organisations, the European Parliament, and particularly the European Court of Auditors, regarding deficiencies in the implementation of budget support.

24. In many ACP countries, EU budget support has been a successful and encouraging experience, offering significant comparative advantages, given the current economic context and the challenges to be met. This is clearly illustrated by the growing number of recipient countries and the volume of budget support.

25. Nevertheless, there is still room for improvement, and in that regard, the Green Paper mentions several points for discussion:

- political governance and the role of policy dialogue;
- the role of dialogue on the policies to be implemented and conditionality, and the links between performance and results;
- national accountability and mutual accountability;
- the programming of BA, and its coherence with other EU instruments and those of other donors;
- the strengthening of risk assessment, and the fight against fraud and corruption;
- budget support in countries which find themselves in difficult situations;
- growth, fiscal policy and the mobilisation of national resources.

#### **4. Observations on the future of European Union budget support**

26. The issue of the future of budget support has arisen at a time at which the EU finds itself at a crossroad in its development. The ongoing consultation process is part of a more global review of EU cooperation policy instruments being conducted in a context of institutional reform occasioned by the entry into force of the Lisbon Treaty, and in an ever-changing global environment in which the EU is seeking to adjust to the challenges of current global geopolitics.

27. The publication of the Green Paper and the public consultation on budget support also come against a backdrop of repeated criticism from the Court of Auditors. Although the reports produced by the Court are only advisory, their recommendations are taken very seriously by the Commission, and undoubtedly will have a considerable bearing on how the EU's budget support policy evolves. On the pretext of risk management and effectiveness, this could, in fact, lead to a reduction in aid as budget support or to giving preference to any given variant.

28. The Court's criticisms may lead to a tightening of the EU budget support policy, especially as regards the assessment of eligibility criteria—and particularly the management of public finances—and the definition and evaluation of objectives and performance indicators.

29. The consultation process will culminate with an EC statement on EU budget support policy, followed by a Council decision. The forthcoming ACP-EC discussions, in the framework of the process to formulate the EU budget support policy, should capitalize on on-the-ground experience gained by the National or Regional Authorising Officers.
30. Future discussions on budget support should focus on the following concerns, which reflect the conclusions of meetings on this issue held by ACP organs, including the meeting of ACP Ministers of Finance in January 2008.

### **1. Policy ownership**

31. Budget support should be implemented in line with the principles of the Cotonou Agreement. Among other things, it should respect the sovereign right of the ACP countries to determine the principles and strategies which guide their development, as well as their economic and social models. Aid policies should enable recipient countries to determine, plan and organize their economic policies in line with their own development strategies, with the role of donors being to support those policies.

### **2. The role of policy dialogue**

32. Budget support entails ongoing dialogue between the partner country and the donor on the policies to be implemented. This dialogue is a crucial step in implementing any budget-support programme.
33. Nevertheless, despite the policy dialogue, in the final analysis, it is the donor who decides whether or not to grant budget support. In that respect, an appropriate and representative framework should be established in which the stakeholders could express their opinions, harmonize their positions, and clarify the role, scope and objectives of the policy dialogue.

### **3. Public finance management**

34. As an eligibility criterion for budget support, the management of public finances must be transparent, reliable and effective. Once the resources have been transferred, they are absorbed into the partner country's budgetary resources, and are no longer within the donor's control should the latter suspect a risk of poor management of public finances.

35. The EC is aware of this risk and is willing to accept it, provided reforms aimed at improving public-finance management are implemented. This dynamic interpretation of Article 61 of the Cotonou Agreement does not seem to have convinced the Court of Auditors, which recommends strengthening risk management practices to better protect EU funds against losses, wastage and ineffectiveness.
36. In that regard, it should be noted, firstly, that there is no international standard or quality benchmark where public finance management is concerned, and secondly, that reforming a country's public finances is a long and complex process. Furthermore, the EC is not the only institution to refer to the prospects for improving public finance management systems rather than to a threshold or an absolute quantitative level. Both the IMF and the World Bank have done as much.

#### **4. Budget support conditionality**

37. The reference to IMF evaluations raises fears of the insidious presence of conditionality requirements, recalling the structural adjustment programmes. This type of conditionality, inspired by the Washington Consensus, is frowned upon by the partner countries, and challenges the principle of policy ownership, which is a key element in aid effectiveness.
38. Budget-support conditionality should focus on promoting policy ownership, achieving set results, and aid effectiveness.

#### **5. Definition of performance indicators**

39. Establishing performance indicators as programme-evaluation tools is of critical importance. As the disbursement of variable tranches is linked to performance, the indicators measuring the latter should be established by mutual agreement between the recipient and the donor(s). The partner countries, which are responsible for implementing the programmes, should be able to take full ownership of them. For the indicators to be effective, they should be relevant, reliable, simple and not too numerous.

#### **6. Capacity building**

40. Policy ownership, the reinforcement of national public-finance management systems, and the choice of performance indicators require building institutional and technical capacity. Without solid capacities, the partner countries can neither fully own nor manage the development process. Although budget support programmes generally provide for a capacity-building strand, the latter should be better targeted. It is up to each partner country to specify its capacity-building needs and priorities.

## **7. Enhancing the predictability of budget support**

41. The multi-annual approach to aid contributes to ensuring greater predictability and stability of resources. In that respect, the current cycle of budget support—three years—is a step forward compared to project aid. Nevertheless, given the impact of the predictability and stability of resources on financial planning and programming, extending the duration of budget support programmes to six (6) years, as is the case for MDG contracts, would further strengthen the effectiveness of policy implementation.

### **Conclusion**

42. Budget support, while not the remedy to the problem of aid, presents comparative advantages over the traditionally adopted project approach. It makes it possible to provide larger amounts of aid, with greater predictability.
43. In its implementation, it has proven to be the aid delivery modality which best fulfils the commitments made in the Paris Declaration, and as such, contributes to improving aid effectiveness.
44. Policy dialogue between the partner country and the donor is one of the key aspects of budget support. In addition to the strengthening of institutional and human capacity it requires, the dialogue should be pursued in the framework of a sincere partnership, going beyond a simple donor-recipient relationship, in order to prevent budget support from becoming—paradoxically—a means of reinforcing donor control and interference in the affairs of the partner countries.
45. This document will be updated with the conclusions of the meeting of National and Regional Authorising Officers. The aim is to prepare for the forthcoming discussions with the EC on the EU budget support policy, stemming from the Green Paper and the public consultation.