Budget support

'A question of mutual trust'

European Commission

Louis Michel
European Commissioner
for Development
and Humanitarian Aid

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Foreword by Louis Michel

'A question of mutual trust'

'I know that budget support is controversial. Although I can accept that there may be situations where this form of aid is impracticable, I am convinced that, where circumstances permit, budget support is the most effective instrument of development.

Firstly because it is the best way to apply what is for me the sacred principle of ownership. Only by respecting this principle can we enable our partners to decide on their priorities for themselves, to feel they are masters of their own destiny and to ensure the success of their actions. With project aid there is always the temptation to interfere in our partners' choice of priorities.

Secondly because it gives meaning and depth to the dialogue between partners and donors. The relationship is by definition much stronger as soon as budget support becomes a decisive factor in the partner's general budget. The budget reflects the government's fundamental policy choices and priorities. It is essentially a statement of its objectives, which reflects its economic and social priorities. Budget support is essential here.

The fact that it is recurrent and predictable and the practical value it represents in operational policy terms for the government are such important advantages that they create much more productive scope for discussion and dialogue. It is much easier to achieve progress in areas such as the rule of law, democracy and improving public finances in this type of context than with any other method.

It is possible to have a real policy dialogue between donors and beneficiaries, enabling much more progress to be made on human rights and education, and social and environmental policies.

Finally, budget support enables funding to be provided for all government budgets, including its operating budget. So it can be used to pay the salaries of teachers, medical staff, judges, etc.

The doubling of the volume of development aid adds a completely new dimension to the debate about project aid versus budget support. If this were to be translated into a doubling of projects the situation would quickly become chaotic and unmanageable for our development partners.

At the moment there are 600 projects involving less than EUR 1 million in the health sector in Mozambique alone. This means that the time and energy of the Minister of Health and his department are taken up in discussions with the various donors involved in the sector. If in future, as the volume of aid increases, we all continue to fund our own micro projects, each with our own requirements, staking our own little claims, we can say goodbye to any aid efficiency agenda.

Budget support and more of it is the only answer. For this reason I have decided to increase the proportion of budget support from 20 % of our funding to 50 %.

I have decided to publish this document to answer the many questions I have received about budget support since taking over as

European Commissioner for development policy, humanitarian aid and relations with African, Caribbean and Pacific States.

I hope that the arguments presented here will convince readers.'

Louis Michel
European Commissioner for Development and Humanitarian Aid

Foreword by Jean Ping

In Africa and elsewhere the issue of good governance and capacity building is more topical than ever. Whether it be for responding to the opportunities and challenges of globalisation or for achieving the Millennium Development Goals, the developing world needs States that are strong, just and capable of performing the natural tasks of government in the interests of their people.

In order to do their work States must have a political vision and adequate means. This is where the national budget comes in. It is much more than a purely technical instrument setting out the State's income and expenditure, it is the government's principal annual strategy document.

The budget embodies the fundamental values underlying the government's main policy choices and reflects its views on the nation's social and economic situation. It is a statement of the government's financial and economic objectives. It reflects the government's social and economic priorities and shows how serious it really is about meeting the Millennium Development Goals. The budget is also a reference tool for evaluating the government's proposals and achievements.

The budget is crucial for ensuring transparency, accountability, completeness and good governance. By setting out in detail the expenditure forecasts, it enables the parliament and the public to know where the money is going, thus contributing to transparency. Moreover, the government needs parliament's backing to commit expenditure or increase tax revenue, which explains the ministers' accountability to parliament and parliamentary committees. Finally, the budget is the regulatory and disciplinary framework within which the ministries must be run and must carry out their tasks.

Transparency and accountability are cardinal principles of democracy which must be present throughout the budgetary process.

Where circumstances permit, donor support in the form of budget support is fundamental for partner countries. Budget support is the aid instrument best suited to fostering a real policy dialogue between donors and partner countries. It also makes for greater accountability, coherence and predictability in the management of aid by the partner country.

Budget support is the best way of establishing a real contract of confidence between development partners.

At a time when international development aid is increasing, largely thanks to the European Union, the need for greater aid efficiency is more essential than ever, and budget support is the most appropriate instrument to achieve this.

This brochure presented by the European Commissioner Louis Michel is therefore a timely initiative to explore the issues surrounding budget support, to answer the questions it raises and dispel the misconceptions that sometimes accompany it.

Jean Ping
President of the Commission of the African Union

Budget support – Questions and answers

This list of questions and answers mainly concerns general budget support and the ACP countries, but most of the principles referred to are readily applicable to sectoral support and other regions of the world.

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1. GENERAL QUESTIONS

1.1. Definition

Budget support is a way of implementing development aid which consists in giving financial aid to the treasuries of the recipient countries. This aid increases the resources available to the recipient country to implement its own budget according to its own procedures. What generally characterises budget support is that it goes directly to the partner governments and is integrated into their own systems of appropriation, procurement and accounts, and is not connected to specific projects. All types of budget support (whether general or sectoral) consist in a lump-sum transfer of foreign exchange; the differences arise from the objectives pursued, the level and focus of the policy dialogue and the conditions and expected results. The aid is given subject to certain conditions of eligibility and implementation.

Budget support differs from other types of aid, in particular in the following ways.

1 – Balance of payments aid, which falls within the remit of the International Monetary Fund. Such funds are intended for the central bank and are designed to increase or maintain foreign exchange reserves.

2 – Project aid, which is when development assistance funds are used for specific projects that are implemented with the procedures of the donors, who retain control of funding.

Budget support is not designed to finance any specific investment but to enable governments to implement their policies; it covers either the whole area of government action in the case of general budget support, or just a sector of it in the case of sectoral budget support. Sectoral budget support differs therefore from general budget support in that it concerns one or more sectors, and is subject to any conditions applied in the sector or sectors concerned.

1.2. What are the advantages of budget support for the beneficiary country?

1 – By contributing to the national budget, budget support helps make the authorities more accountable. Budget support is always entered in the national budget and is therefore subject to the same decision-making procedures and parliamentary controls as domestic revenue and expenditure. In this way the national parliament — a democratic forum — has an important role to play in the process of allocating the budget. A specific project/investment, on the other hand, is a decision taken by the government, without mandatory consultation of parliament.

2 – Budget support injects resources into the national budget as a whole, so enabling the country in question to make investments and meet operating costs — paying teachers or purchasing medicines. Project aid, in contrast, usually finances only institutional support or investments. While investment is vital for meeting people's needs (for schools, health centres, piped water and so on), its economic and social impact would be limited if countries did not have the resources to cover the operating costs. Budget support is therefore the natural complement to projects and can ensure their overall sustainability.

3 – Financial transfers in the form of budget support are managed by the beneficiary countries using their own budgetary procedures and arrangements. Budget support is therefore 'easier' for a recipient country to manage as the procedures and budgetary arrangements are those of its own government. So it does not have to use different procedures, satisfy different objectives or adhere to different

requirements that may be imposed by donors. This is why budget support is more compatible with the principles of harmonisation (avoiding having different procedures and requirements for each donor), alignment (the aid given corresponds to the priorities of the beneficiary country) and national capacity building (which also includes public finance management, since management is directly in the hands of the beneficiary country).

1.3. What are the advantages of budget support for the donor?

1 – Budget support is the best instrument for encouraging our partner countries to implement their strategies to

reduce poverty (or their sectoral strategies), bring about macroeconomic stabilisation and improve public-finance management. Through budget support, donors can promote good governance by supporting the partner country's institutions, especially in the area of public finance.

2 – Of course a country's development calls for specific actions, but what is also needed, at a more fundamental level, is improvement in the country's own capacity, the effectiveness of its systems, its organisation and its institutions. One-off forms of aid (e.g. projects) will therefore either continue to expand, which would be unmanageable for the partner countries, or make way for other, more comprehensive forms of aid or be used to underpin improvements in national systems. Budget support is part of this inevitable trend towards more effective aid that is channelled through national institutions that shoulder their responsibilities.

3 – Budget support gives donors a right of scrutiny and dialogue/assessment in respect of the partner country's whole budget (if only through its budgetisation). Donors thus have an overall view of revenue as well as all planned expenditure. Donors providing budget support can therefore give their opinion on the budget and the various stages in the domestic budgetary procedure. The influence the Commission may have (directly or indirectly) on a country's budgetary choices calls for an overall vision of all the country's political priorities and thus provides a framework for broader dialogue encompassing other forms of aid.

1.4. What is the difference between general budget support and sectoral budget support? What are their different objectives?

All budget support consists in providing resources for the national budget of the beneficiary country, but there are the following differences.

General budget support from the Commission is designed to promote overall development policy and poverty reduction by improving living standards (notably as measured by health and education indicators) and public-finance management. As a general rule, in the interests of effective monitoring and evaluation of the results focused on priority objectives, just a few indicators are used. The financing made available to support the country's general policy framework gives the Commission an overall view, so enabling it to discuss with the government any areas where improvements may be needed (economic policy, budgetary choices, justice, etc.).

Sectoral budget support provides an opportunity for a more detailed discussion on one or more sectors, but such a dialogue is by definition limited to the sector(s) concerned. The preparation of sectoral budget support also raises difficulties that are different to those of general budget support; it calls for know-how in various areas as a basis for in-depth sectoral analysis and specific dialogue.

The Commission uses sectoral budget support whenever it thinks that focusing dialogue and attention on an individual sector of its cooperation programme with the partner country offers significant value-added. Sectoral budget support is not direct funding for a given sector. Like general budget support, it is not allocated and the decision on the amount of financing for the sector is taken in the framework of the overall budgetary discussions. However, it provides predictable resources that enable a country to strengthen its sectoral policy, in particular by drawing up a medium-term financial perspective for the sector. The dialogue accompanying sectoral budget support covers many issues relating to financing of the sector (the level and make-up of spending, budget implementation, etc.), implementation of reforms and progress towards sectoral objectives.

In some countries where cooperation is proceeding satisfactorily there may be both general budget support and sectoral budget support for sectors given priority in programming.

In countries less dependent on external aid it is definitely preferable to provide sectoral support in order to achieve a significant sectoral impact.

1.5. Is budget support a way of fulfilling commitments made under the Paris Declaration? What are the criteria governing it?

Budget support is the most suitable form of development aid for fulfilling commitments under the Paris Declaration on aid effectiveness.

The Paris Declaration provides for five areas of action: appropriation by the beneficiary country, alignment on the priorities and procedures of the beneficiary country, harmonisation of donor action, results-oriented management and mutual accountability. Each action area has its indicators of progress and, while budget support does not constitute an indicator as such in the Paris Declaration, the attainment of the objectives measured by these indicators is made easier by using this instrument.

In particular, budget support, by its very nature, promotes alignment on the procedures of the partner country (seven of the twelve progress indicators) since its own procedures will be the reference point.

1.6. What proportion of aid is budget support [9th and 10th European Development Funds (EDFs)]?

The share of aid in the form of budget support has grown steadily since the 1990s. But traditional projects (roads, infrastructure and the like) still account for most aid.

At the beginning of the 9th EDF general budget support accounted for 25 % of programmable funding. Under the 10th EDF the Commission aims to increase budget support, both general and sectoral, to 44 % of programmable funds, 25 % of all available funding.

1.7. What is the opinion of the European Court of Auditors on certain important aspects of budget support?

Concerned about the sound management of Community funds, the Court of Auditors has focused its attention on the public-finance management of budget support by the beneficiary countries. In its 'Special report No 2/2005 concerning the budget support of the EDF for the ACP countries: management by the Commission of the reform stage of public finance', pp. 18–19, the Court comments as follows on the management of budget support.

'The Commission interprets the conditions set out by Article 61(2) of the Cotonou Agreement in a dynamic manner. In its view, the weaknesses affecting public-finance management at the time of the financing decision do not preclude the launch of a budget aid programme, provided that the will for reform exists and the reforms are deemed to be satisfactory. In this way it takes account not only of the initial situation of public-finance management systems, but also of the direction being taken by the country. Many other donors, including the Bretton Woods institutions, similarly take account of the prospect of improving public-finance management systems, rather than merely referring to a threshold value or an absolute qualitative level. This interpretation extends the scope of this particular provision and thus increases the risk to which European taxpayers' money is exposed, because it is the beneficiary countries' national budgetary procedures that are being used. Such an interpretation requires much more rigorous monitoring of the situation and subsequent development of public-finance management in the countries in question.'

Like other donors providing budget support, the Commission bases its proposals and decisions on eligibility for budget support as regards public-finance management on an assessment of the initial situation and the prospects for improvement in the situation. Such analysis means that the Commission is selective in its interventions.

This dynamic interpretation of the conditions for eligibility, in particular the condition concerning public-finance management, may increase the short-term risk. But the selective approach that this entails, based on rigorous analysis and the will of the beneficiary countries to reform, and backed up by capacity-building, makes it possible to reduce and manage this risk.

This requires rigorous follow-up-evaluation combined with close cooperation with other development partners. The Commission agrees with the Court of Auditors, which in the course of the 2006 and 2007 DAS found that evaluations of the fulfilment of eligibility criteria (in particular concerning public-finance management) and disbursement decisions should be more structured and formalised. The Commission also admits that financing agreements and TAPs (technical and administrative provisions) should be clearer and more to the point, in particular as regards performance indicators.

With reference to Article 61(2) of the Cotonou Agreement, which is echoed in similar clauses in the neighbourhood policy and development cooperation agreements, auditors, principally the European Court of Auditors, would like to see a threshold applied to the quality of the public-finance management in the beneficiary countries, below which the country concerned would not be eligible for budget support. Apart from the fact that there is no international standard to set such a threshold, adopting this approach would occasion real disadvantages and dangers, as the Commission has often pointed out, including:

— no threshold is applied by the Bretton Woods institutions;
— no possibility of intervening in the countries which most need it in order to develop true partnerships aimed at improving the situation;
— a changing environment may greatly influence the quality of the public-finance management in the very short term;

— the danger that the beneficiary country may interpret any minimum standard as a necessary but also sufficient condition for eligibility;
— the complexity of public-finance management and the sheer scale of public finances;
— etc.

The Commission:

1 – carries out regular rigorous analyses of partner countries' public-finance systems using internationally recognised methodologies;

2 – makes serious assessments of the programme to reform public finances that a government has undertaken to carry out;

3 – regularly monitors the implementation of such reform programmes;

4 – identifies the key measures that have to be implemented before the variable tranches are released.

1.8. Are parliaments and civil society in the partner countries excluded from the dialogue and from implementation of budget support?

Budget support is sometimes perceived as the fruit of special and exclusive relationships between governments and donors, relationships that might usurp and weaken the role of the other national stakeholders. That is true, but the dialogue accompanying the assessment of the country's performance, which is conducted jointly by governments and budget-support donors, is increasingly comprehensive and structured. This dialogue may fully embrace the non-State actors active in the field.

What is more, budget support also strengthens national parliaments and civil society in various ways.

1 – Budget support is always entered in the national budget and is therefore subject to the same decision-making procedures and parliamentary controls as domestic revenue and expenditure. This is not true of project aid.

2 – As a result of programmes to reform public-finance management, which often include measures to improve transparency, budget support increases accountability to civil society and the legislature (public access to the main contents of the budget, parliamentary scrutiny of external audit reports, etc.).

3 – Civil society and parliaments are increasingly called on to take direct part in the performance-assessment procedures and joint reviews forming the framework in which budget support is implemented.

1.9. Does budget support mean that central government acquires more resources and powers to the detriment of local government?

Since budget support is disbursed in the form of transfers to the general accounts of the national treasury, it does not finance local government directly. However, like own resources, it contributes to the financing of transfers and grants to local bodies as provided for by the laws and budgetary policy of the country in question.

But experience shows that decentralisation is becoming more important in the dialogue on implementation of budget support. The transparency of allocations and the medium-term predictability of funds made available to local government are therefore becoming central to public-finance-management reform programmes.

The level of financial transfers in relation to the powers transferred is also becoming a key issue in the dialogue on the provision of public services, responsibility for which is being given to local administrations. Human and financial capacity building for local government is therefore increasingly often found among the objectives of budget-support programmes.

1.10. What is the Millenium Development Goal (MDG) contract as opposed to 'traditional' general budget support?

Achieving the MDGs calls for a long-term increase in public expenditure, not only capital expenditure but also current expenditure, such as wages for teachers and nurses. But finance ministries are reluctant to make long-term commitments to increase current expenditure in the absence of firm pledges concerning the availability of the corresponding financial resources, above all external resources. External official assistance is still insufficiently predictable to meet these needs.

Under the 10th EDF the Commission intends to make general budget support more predictable. The aim of the MDG contract is precisely to increase predictability and so facilitate the medium-term planning, budgeting and financing of the expenditure required to achieve the MDGs.

The main features of the MDG contract are:

— all the resources for budget support that are programmed in the 10th EDF country strategy papers would be committed for a six-year period corresponding to the life of the fund;
— the beneficiary country would have the assurance that the bulk of the amounts committed (at least 70 %) will be disbursed as long as they meet the eligibility criteria for budget support, plus the essential and fundamental principles of cooperation;
— each year there would be an annual review of the country's performance which, in the event of specific and

serious concerns, could lead to withdrawal of a maximum of 15 % of the annual amount to be disbursed;

— at least 15 % of the total commitment would be linked to results (in particular progress towards the MDGs) as evaluated at the mid-term review. This annual disbursement amount would be set for the second part of the programme;
— the eligible countries would be those which have already clearly proved themselves in implementing budget support, which pursue a clear policy of setting out to achieve the MDGs and which have a good medium-term framework for monitoring this policy and for coordination with technical and financial partners.

2. MECHANISMS FOR IMPLEMENTING BUDGET-SUPPORT PROGRAMMES

2.1. Can budget support be given in all countries? What are the chief criteria for choosing this form of implementation?

No. Budget support **cannot be implemented in all countries or in all circumstances**. The determining criteria for the use of budget support as a means of implementation of development aid are those concerning the eligibility of a country for this instrument. All the legal bases now set out the main elements to be taken into account for eligibility for budget support and they cover the same issues and areas.

Article 25 of the financing instrument for development cooperation, based on Articles 61 and 67 of the Cotonou Agreement, gives a good summary of the eligibility criteria:

'Community financing may take the following forms:

[…]

(b) budget support if the partner country's management of public spending is sufficiently transparent, reliable and effective, and where it has put in place properly formulated sectoral or macroeconomic policies positively assessed by its principal donors, including, where relevant, the international financial institutions.

[…]

The Commission shall consistently use an approach based on results and performance indicators and shall clearly define and monitor its conditionality and support efforts of partner countries to develop parliamentary control and audit capacities and to increase transparency and public access to information. Disbursement of budget support shall be conditional on satisfactory progress towards achieving the objectives in terms of impact and results.'

Budget support cannot be used to help countries at any time and or in any circumstances. As made clear in the European Consensus on Development, recourse to budget support is one of the various ways of channelling development aid 'where circumstances permit'(point 26).

In addition to the political conditions making it possible to carry out a programme of cooperation with a partner country, this entails assessing fulfilment of eligibility criteria such as those provided for in the Cotonou Agreement. In practical terms the eligibility criteria are:

(i) a well-defined national or sectoral policy and strategy;
(ii) a stability-oriented macroeconomic policy; and
(iii) a credible and relevant programme to improve public-finance management.

2.2. What aspects of beneficiary countries' public finances are examined?

The quality of public-finance management is one of the key issues when considering a country's eligibility for budget support. The Commission administers this condition on a case-by-case basis because there are no recognised international standards and because improving the management of public finances is a development objective in its own right. It is important to monitor, accompany and support the desired improvements.

The Commission, together with a large group of donors, has developed the 'public-finance management performance measurement framework', enabling the study of all dimensions of public-finance management:

— the credibility of the budget,
— the comprehensiveness and transparency of the budget [1],
— policy-based budgeting,
— predictability in and control over budget execution,
— accounting and recording,
— financial reporting,
— budgetary monitoring, and
— external scrutiny.

The Commission and the other donor partners also look at sectoral, intersectoral and intrasectoral budget spending and allocations. Though the focus is on overview, it also shows:

[1] *Transparency of public finances refers to the aim of throwing light on the structure and functions of the state institutions which determine budgetary policy and results, and the past, present and future activities of the government. This transparency makes for better informed public debate, and also strengthens the accountability and credibility of the public authorities. To encourage greater transparency in public finances, the International Monetary Fund has drawn up a 'Code of good practices' and published a 'Manual on fiscal transparency' and a 'Guide on resource revenue transparency', which were updated in 2007.*

— the extent to which social spending is favoured over, say, sensitive expenditure such as the military, and
— whether the balance between centralised and decentralised expenditure reflects the policies announced by the government.

2.3. What are the implementation procedures (programming, identification, etc.)? What is the role of the Member States?

Each country receiving development aid signs a country strategy paper, accompanied by a national indicative programme (NIP), with the Commission. These papers set out the priority sectors for action and the proposed implementation arrangements (in the NIP). Both the country strategy papers and the NIPs are submitted to the EDF Committee for approval by the Member States.

Budget-support programmes are then prepared just like any other programme, i.e. going through the phases of programming and identification, finishing with formulation and the financing decision.

1 – The programming stage consists mainly in assessing the likely impact of budget support and its potential contribution to the objectives of the European Commission's aid strategy in each country. For example, general budget support can underpin the implementation of a medium- to long-term national development strategy and/or contribute to short-term macroeconomic stability. Similarly, sectoral budgetary aid can support the implementation of a sectoral development strategy.

2 – The identification stage consists of an objective analysis of the national situation with the aim of drafting an initial programme description, focusing on finding confirmation that the eligibility criteria — domestic policies and strategy, macroeconomic framework and public-finance management — will be met before the end of the formulation phase. It is also important to evaluate the partner country's will and capacity to use performance criteria and indicators for payments and to play a proactive role in coordination with donors.

3 – The formulation stage that follows involves preparation of an 'action fiche', followed by a financing agreement to be signed with the partner country. The formulation stage is when all the elements of the programme are set out in detail and the grounds for the intervention given: the national situation (including adherence to the eligibility criteria); description (objectives, expected results, main activities); and the implementation arrangements.

Under the 10th European Development Fund, action programmes are drafted by the Commission and the country or partner region, with the participation of the EU Member States represented on the ground and in coordination with other donors, particularly in the case of joint programming, and with the European Investment Bank. These programmes outline the general framework and evaluate lessons learned, including in the area of budget support, based on annual operational examinations. They consist of detailed individual fiches for each action foreseen, which contain an analysis of the situation in the sector concerned, a description of the actions to be financed, the main partners, the expected results expressed in qualitative and quantitative indicators, the management procedures, an indicative calendar for implementation and, in the case of budget support, the criteria for disbursement including any variable tranche. These action programmes are presented to the EDF Committee for agreement.

Within the EDF Committee, the votes of the Member States are weighted as follows: Belgium 35, Bulgaria 1, Czech Republic 5, Denmark 20, Germany 205, Estonia 1, Ireland 9, Greece 15, Spain 79, France 196, Italy 129, Cyprus 1, Latvia 1, Lithuania 1, Luxembourg 3, Hungary 6, Malta 1, the Netherlands 49, Austria 24, Poland 13, Portugal 12, Romania 4, Slovenia 2, Slovakia 2, Finland 15, Sweden 27 and the United Kingdom 148. That makes an EU-27 total of 1 004. The EDF Committee acts by a qualified majority of 724 votes out of 1 004, expressing a vote in favour by at least 14 Member States. The blocking minority is 281 votes.

The financing agreement, which formalises the contract with the partner country, should specify the performance criteria and indicators for payments and the procedures for payment (timetable, methods and assessment criteria).

The role of the Member States in detail

The amounts of the annual tranche(s) are first specified in the financing proposal/action fiche which goes to the EDF Committee — there receiving the opinion of the Member States — and then in the 'technical and administrative provisions' and the financing agreement, which together constitute the true contract with the government of the beneficiary country. The financing proposal/action fiche also contains the indicative timetable of payments and, of course, the prior performance evaluations. This also appears in the technical and administrative provisions of the financing agreements.

When Commission programmes are implemented in contexts where the beneficiary country also receives support from the other donors — which is the case almost everywhere in the ACP region [Heavily Indebted Poor Countries (HIPC), Poverty Reduction Strategy Paper Countries (PRSP) countries, fragile States, etc.] — the programme reviews are often carried out jointly, especially with any Member States concerned.

The Commission usually disburses the fixed tranche at the beginning of a financial year and the variable tranche in the middle of the year when, for example, the previous year's budget performance can be evaluated and input given for the preparation of the following year's budget. These elements are thus presented when the programmes are drawn up, made known to the Member States (especially where multidonor programmes are involved) and are consistent with national timetables.

There are therefore systems of formal cooperation (management committees) plus, where necessary, concertation/harmonisation/coordination in the beneficiary country.

2.4. At what stage are countries assessed with a view to budget support?

An appraisal of the eligibility criteria, namely (i) a well-defined national or sectoral policy and strategy; (ii) a stability-oriented macroeconomic policy; and (iii) a credible and relevant programme to improve public-finance management, must be carried out:

— before finalisation of any budget-support programme;
— during implementation of the programme;
— and, above all, before each disbursement.

So budget support may be accorded to a country emerging from a major crisis which needs to get its administration up and running again, but it will be subject to agreement on a minimum national strategy, to the macroeconomic situation being under control and to a will to improve the management and use of public funds. These are the prerequisites.

2.5. Can budget support be given in any sector?

In theory yes, budget support may be used as an instrument for implementing support for a sectoral priority, whatever the sector concerned. But budget support will be all the more effective if the State plays a decisive role in the sector in question, either because it is the leading actor through the budget (true of health, education and civil protection) or because it is the regulator of the sectoral policy or the engine of the reforms to be undertaken and implemented in the sector. So the sectors we are talking about are those where the role of the public sector is well

defined or where sectoral strategies are in place, and where responsibilities are relatively well specified. Budget support is thus the most transparent way of supporting public policies. Support for independent institutions, non-State actors or a variety of actors does not lend itself so readily to budget support.

2.6. How does the Commission respond to the priorities of a country receiving budget support?

The Commission responds to them by definition, because so doing is inherent in the eligibility criteria for budget support, The national budget reflects national priorities, and budget support may be given only for a well-defined national, general or sectoral policy. The Commission's budget support is therefore part of the response to the country's domestic priorities. Its effectiveness will be increased if:

— priorities are clear and detailed;
— well-defined action plans are drawn up:
— the costs of implementing these action plans are quantified and reflected in the budgets;
— monitoring systems are set up;
— results are regularly evaluated and analysed.

Budget support contributes to the constitution of the financial resources provided for in the national budget, which usually reflect the priorities and policies adopted.

2.7. How is consistency between donors ensured when deciding what form support should take?

Consistency between donors on the form of support is ensured:

1 – through the programming, identification and formulation processes;

2 – through confirmation at each critical stage of the implementation process; the donors consult each other at every stage, often in formal coordination frameworks.

There should not, therefore, be any differences of opinion when assessing the national situation and when deciding what form support should take.

It should, however, be emphasised that it is for the partner country to take the lead in steering donor coordination so that the different support arrangements are in sync, for instance, where conditions allow this, by requesting a technical support project to supplement a broader budget-support programme.

More generally, the partner country chooses with the donors the form (project aid, budget support, humanitarian aid, emergency assistance, etc.) most appropriate to the circumstances.

2.8. How is donor coordination ensured when implementing budget support at the time of reviews and disbursement decisions?

Budget support always involves a high level of coordination between the donors and the partner country, and that coordination is, by its very nature, in phase with national processes and timetables.

The nature of coordination can vary from country to country: there may be a formal system laid down by a memorandum (with each party having specific and detailed rights and obligations) or a more informal system with coordination meetings.

For general budget support in particular, it is important that the coordination system involve the use of a common performance assessment framework enabling stock to be taken of the year gone by and the objectives for the current and coming years to be assessed.

Whatever the coordination method, it will enable all donors to coordinate their positions on major developments in national policy and strategy, macroeconomic policy and public-finance management reform.

Subject to compliance with their internal decision-making processes, donors can each act on these joint reviews to notify their intentions in the matter of disbursement, sound each other out and reach a broad consensus.

2.9. Are disbursement decisions taken individually or collectively?

Donors generally share evaluations upstream of disbursement decisions in the interests of data consistency and harmonisation. A disbursement decision, however, is ultimately a matter for the individual donor under the agreement with the partner country and its own decision-making procedures.

For instance, each donor may, while referring to a common set of criteria and evaluation indicators, decide, in agreement with the government, which parameters of the simplified and limited framework it itself uses as a basis for its evaluation and final decision on disbursement. Thus, the donors follow a harmonised approach (common framework) but are not necessarily unanimous (evaluation carried out individually with some weight given to national political priorities). This is important for ensuring a degree of predictability for the partner country.

2.10. In what circumstances may budget support be suspended?

A budget-support programme may be suspended in the light of the following.

1 – Eligibility conditions: If certain eligibility conditions are no longer met, the programme would be suspended, i.e. disbursements would cease. A deterioration in the macroeconomic and/or budget situation or adverse developments in the management of public finance are legitimate grounds for suspension, since the climate is no longer conducive to reasonable aid effectiveness. Remedial measures are then planned to restore suitable conditions for the resumption of budget support.

2 – State of the country's policy-making: Support can also be suspended when national policy is ill-conceived or its implementation particularly poor. However, this assessment would normally be reached upstream of any financing decision.

3 – Essential elements: Democracy, human rights and governance are essential elements of EU cooperation, as set out in Article 9 of the Cotonou Agreement. They are dealt with in the political dialogue provided for in Article 8 of the Agreement, which authorises suspension of aid (Article 96), if this is justified by changes in the general governance context.

2.11. What is the role of the International Monetary Fund (IMF)?

The IMF's mandate from its members is clear and specific: 'To promote global economic stability through multilateral cooperation, the IMF has been given the mandate of overseeing the international monetary system and monitoring the economic and financial policies of its 185 member countries. This activity is known as surveillance. IMF surveillance provides an expert assessment of economic and financial developments, both globally and in individual countries. It advises on risks to stability and growth and if policy adjustments are warranted. In this way, the IMF helps the international monetary system serve its essential purpose of providing a framework that facilitates the exchange of goods, services, and capital among countries and sustains sound economic growth.'

The Commission as such is not represented on the IMF's Board of Governors, membership being confined to the Member States.

So the Commission is not under a formal obligation to follow the IMF's advice and/or recommendations.

However, the IMF has valuable and recognised know-how, and the Commission uses it where official programmes [Poverty Reduction and Growth Facility (PRGF), standby arrangements, etc.] exist, in which case it has a contractual relationship with the beneficiary country. A country that has an agreement with the IMF is automatically eligible for budget support (Article 67(4) of Cotonou). In practice we look at the three eligibility criteria.

The Commission carries out a case-by-case analysis for countries without an IMF programme. In such cases the studies carried out by the IMF for the purposes of consultations under Article IV of its Articles of Agreement are of great help to the Commission when forming an opinion on the macroeconomic and budgetary situation.

But in the final analysis, whatever the value and use made of the information provided by the fund, the decisions are taken by the Commission.

3. MANAGEMENT OF PUBLIC FINANCES

3.1. Are studies carried out on the management of public finances?

Yes, they are becoming systematic. The nature of budget support makes the programming and execution (and the supervision of that execution) of the national budget of paramount importance. The effectiveness of budget support will depend in part on that process. This is why it is necessary to study the beneficiary country's management of its public finances.

These studies are carried out (normally using methods developed with other donors, including the Bretton Woods institutions and certain Member States) as the first step in assessing the eligibility criterion of quality of public-finance management.

The second factor will be whether there is a programme to improve the management of public finances.

Where other donors have carried out studies, the Commission uses them; if not, it has studies carried out.

3.2. Why does the Commission not draw up minimum criteria for the management of public finances for the purposes of granting budget support?

The Commission has a dynamic approach to evaluation. Strengthening the public-finance management system has become a development-aid objective owing to its impact on the use and effectiveness of the government's and donors' financial resources.

Where there is a relevant and credible public-finance management reform programme, budget support and use of national systems help strengthen the reform programme and these systems.

When considering the advisability of granting a country budget support, it is very important to weigh the benefits of improving national systems against the risks that resources will be misused.

If minimum criteria for public-finance management are laid down in advance, in the absence of recognised international standards, it would not be possible to make such a dynamic evaluation of the progress made and promising trends.

Indeed, the overall evaluation conducted by the OECD-DAC confirms that general budget support has helped improve the management and effectiveness of public spending.

3.3. Is technical support for improving the management of public finances provided?

Technical support is generally provided in the area of public finances. In some general budget-support programmes it accounts for over 5 % of the programme.

It is generally provided in coordination with the other donors involved and reflects the priority measures jointly identified on the basis of the shortcomings observed and the reform programmes adopted by the beneficiary authorities.

It covers all areas of public finance and increasingly takes in external control and supervisory bodies (courts of auditors and parliaments).

3.4. Can all expenditure be scrutinised? What means are there for influencing budgeting?

Since the budget dialogue covers all expenditure — and indeed revenue — all aspects of a budget can be scrutinised by the various partners. The Commission, with the other donors and increasingly with the legislator, too, evaluates the composition of the budget at the various stages of the national budget procedure. The Commission's influence over a country's budgetary choices concerns the results sought rather than the key budget aggregates, thereby leaving the choice of means to the government's discretion. Discussion of budget policy nevertheless forms part of the general dialogue between the different partners.

4. FINANCIAL CONTROL

4.1. What mechanisms are there for controlling misuse and fraud?

There are two levels of control mechanisms for misuse and fraud: that of the budget-support programme and that of the framework for overall cooperation with the country.

1 – At the budget-support programme level, given the manner of its execution, namely direct centralised management, misuse and fraud concern 'the presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds' and the other obligations set out in the general conditions of the financing agreement, and more specifically in Article 14 concerning the prevention of irregularities, fraud and corruption. The implementation of budget support involves the submission of supporting documents in order for funds to be paid to the exchequer of the beneficiary country. These supporting documents are documents necessary to prove compliance with the disbursement criteria laid down in the financing agreement.

2 – As regards overall cooperation with the partner country, only serious cases of active and passive corruption constitute a violation of the fundamental element under Article 9 of the Cotonou Agreement. Article 97 of the Cotonou Agreement lays down the procedures to be followed in serious cases of corruption.

4.2. Is there an early-warning system that can identify slippages between regular reviews?

The Commission monitors — via its delegations on the ground — the different stages in the life cycle of programmes for which it is responsible. If slippages occur in areas relating to eligibility criteria or in performance monitoring, they will be detected before regular reviews. The Commission and its donor partners have established systems for regular monitoring.

Furthermore, the instructions to delegations and the Guide on Budget support provide for an early-warning system enabling the relevant level of the Commission hierarchy to decide measures to cushion the impact of a deterioration in the situation.

4.3. What are the options in the event of misuse and fraud? Can sums be recovered if the supporting documents for disbursements are found to contain irregularities?

There are a whole range of options, from suspending disbursements to closing down programmes.

— If irregularities are detected before disbursement, the Commission will not make the transfers provided for in the financing agreement.
— If irregularities are detected after disbursement, Article 14 of the general conditions of the financing agreement for budget support provides for the partner country, at the Commission's request, to take the measures

and initiate the proceedings necessary to recover the unduly paid funds.

It is therefore possible to recover sums in the event of irregularities.

5. TAKING STOCK OF THE RESULTS

5.1. Is it possible to prove that budget support is working?

Given the impact of aid on development, the Commission has developed a results-led approach linking the sums disbursed to a series of indicators that are part of the government's commitments and which make it possible to verify improvements in access to public or subsidised services (e.g. vaccination or school enrolment of girls).

This method used by the Commission to implement budget support is geared to results and specifically aimed at providing the means of evaluating the effectiveness of this form of aid in terms of its contribution to policies in the areas of development, reducing poverty and improving the management of public finances.

In keeping with the same logic, the methodology is also aimed at encouraging the beneficiary countries to gradually develop their own capacity to assess their policies by strengthening and owning their monitoring and evaluation machinery and statistical systems.

5.2. Does the Commission evaluate the results of budget support?

In 2004–05 the Commission had a cross-cutting study carried out into the implementation of its budget support and the results obtained. This study, which covered 34 budget support programmes implemented in the period up to 2004 in 20 ACP countries, was published in February

2005 under the title 'EC budget support: An innovative approach to conditionality'.

A second study of the same kind is now being finalised; it covers the period 2004–07 and 46 programmes in 27 ACP countries.

The two studies examine in detail the variable-tranche mechanism and the performance indicators established by the Commission.

Commission budget support in seven countries [2] has also been the subject of a joint evaluation [3] based on the OECD Development Assistance Committee's standard criteria (relevance, efficiency, effectiveness, impact and sustainability). This evaluation was published in May 2006 as 'Joint evaluation of general budget support 1994-2004'. The overall conclusions of this study were broadly positive as regards the effectiveness of budget support, including the results achieved.

The Commission is also preparing a new methodology for evaluating budget support, which was recently presented to the OECD-DAC; reflecting the Commission's general results-led approach, it will underpin future evaluations of budget-support programmes.

([2]) *Burkina Faso, Malawi, Mozambique, Rwanda, Uganda, Nicaragua, Vietnam.*

([3]) *Ten Member States took part in the joint evaluation: Belgium, Denmark, France, Germany, Ireland, Netherlands, Portugal, Spain, Sweden, United Kingdom.*

5.3. Are there reliable methods for evaluating budget support?

The evaluation of budget support is complicated by the fact that it is very difficult to distinguish budget support's specific contribution to achieving the targeted results, i.e. the results of the national policy.

However, a number of major multidonor evaluations have recently led to improvements in methods, in particular the evaluation not only of results but of contributing factors, offering a clearer picture of the part played by budget support.

The European Commission is currently finalising a methodology for evaluating budget support which takes account of the considerable contribution made by recent evaluations. An initial draft of this methodology will be presented to other leading donors as a discussion document with the ultimate objective of systematically conducting joint evaluations of general and sectoral budget support programmes.

5.4. Are the monitoring systems reliable?

The reliability and effectiveness of monitoring and evaluation systems depend on the countries concerned and are based on two key parameters.

— The organisation of the system: to be effective, a monitoring and evaluation system must meet a number of conditions: (i) ownership of the system and its application by the country, (ii) relevance to the country's needs, especially those of the line ministries involved,

in terms of its development and poverty-reduction strategies, (iii) a shared and joint analysis of the results identified by the country and its technical and financial partners, (iv) based on this analysis, initiation of a dialogue between the country and its technical and financial partners to remedy the shortcomings identified.
— The quality, reliability and availability at the right time of the statistical data on which the system depends.

5.5. How can monitoring systems be improved?

The Commission's budget support, like that of the other technical and financial partners involved in this type of assistance, has done much to help structure monitoring and evaluation systems, promoting the establishment of common frameworks for organising budget support and assessing performance (including matrices of measures and performance indicators) ([4]).

The Commission and the other technical and financial partners have also provided specific technical support measures to strengthen statistical systems. In liaison with the World Bank, the Commission is planning to apply sector-wide approaches (SWAPs). It is currently assessing statistical systems and needs to identify four or five countries in which to test this new approach.

5.6. Can tangible results be seen in terms of: growth, public-finance management, poverty reduction, Millenium Development Goals (MDGs)?

The joint evaluation of general budget support conducted by a group of 24 donors and seven partner countries formulated observations and conclusions concerning results in terms of growth, poverty reduction and public-finance management.

Given the multitude of factors determining growth and poverty reduction, the study was not able to determine the direct effects of general budget support on them with sufficient certainty. However, all the countries covered saw a reduction in poverty over the period studied, and there was an increase in the provision of basic services owing to the

([4]) *In Burkina Faso's case, for instance, these would be the general organisational framework for budget support for the implementation of the poverty reduction strategy paper (CGAB-CSLP) and the review of the priority action programme for the implementation of the poverty reduction strategy paper (PAP-CSLP).*

commitment of donors and government alike to improving services considered to have an impact on poverty.

With regard to public-finance management, the evaluation concluded that general budget support helped improve the partner countries' public-finance management, rendering it more comprehensive, better controlled and more transparent.

5.7. Why does the Commission focus on results rather than imposing specific measures?

In response to the legitimate concerns of civil society, Parliament and other development players regarding the effectiveness of this type of assistance, the Commission has developed an innovative, results-led approach linking the sums disbursed to a series of indicators agreed with the country and enabling real improvements in public welfare services (e.g. vaccination or school enrolment of girls) to be verified. The approach is also motivated by a desire to respect countries' policy choices while making them accountable for the results achieved.

This makes it possible to have a dialogue based on facts rather than ideology, to keep the focus on improving people's living conditions.

This approach upholds the principle of ownership of policies by the countries themselves and leaves space for a national democratic debate on the policies needed, while requiring these policies to be effective.

The Commission limits the use of prior conditions in the implementation of programmes, drawing on its past experience with structural adjustment programmes and the errors made by imposing what were believed to the right policies. In the early 1990s donors used conditionality to push many African countries into, for example, charging for access to schools and health centres. Ten years later the same institutions are pressing for the abolition of these charges. In both cases the pressure is contentious: some charges may be acceptable, others not, but this is a policy decision for the country itself. What is important is that there should be an improvement in access to services, and this is what the Commission focuses on.

5.8. Is setting conditions an effective way of evaluating performance?

There are two types of conditions for aid programmes:

1 – conditions based on measurement or processes, and

2 – results-related conditions, e.g. conditions based on quantified indicators.

Such indicators are by definition crucial for evaluating the performance of a programme. Moreover, the inclusion of quantified conditions often serves to reinforce beneficiary countries' statistical systems.

Conditions relating to measures or processes concern the measures that must be taken before results can be achieved, but they are not intrinsically directly related to the results.

5.9. What factors govern the choice of implementing arrangements?

The most important factors when choosing implementing arrangements are:

1 – the partner country's objectives,

2 – the European Commission's objectives, and

3 – the main constraints identified beforehand.

In the case of budget support, the objectives of the partner country and the European Commission play a major role in as much as they aim for ownership, alignment, harmonisation, results-oriented management and mutual accountability. The pursuit of these objectives, as laid down in the Paris Declaration, argues for the use of budget support.

Achievement of these objectives is, however, subject to constraints in terms of overall cooperation policy and technical constraints, in particular the legal basis, compliance with eligibility criteria in the areas of national or sectoral policy and strategy, and macroeconomic and public-finance management.

6. SPECIAL SITUATIONS

6.1. How should budget support be managed in a country where the situation is deteriorating?

1 – Budget support is used as a way of implementing aid only in countries satisfying certain eligibility criteria (see Section II). Political (and policy) changes, internal political tensions, weak representative structures and institutions can jeopardise the continuity of government action and thus the effectiveness of general budget support, which relies on national systems. Democratisation and development are interlinked processes, and the relationship between them has to be assessed correctly.

2 – Democracy, human rights and governance are essential elements of EU cooperation, as provided for in Article 9 of the Cotonou Agreement. They are dealt with in the political dialogue provided for in Article 8 of the Agreement, which authorises suspension of all forms of aid (Article 96), not only budget support, if this is justified by changes in the general governance context. So in the event of a deterioration in the political environment, it is aid in general which is under threat, not just the aid of an individual instrument.

This is a direct result of the fact that budget support touches on all public/government functions, which strengthens our position as donor in the political dialogue provided for in Article 8 of the Cotonou Agreement. The consequences of any application of Article 96 are much more serious, and this strengthens our negotiating position on the essential elements referred to in Article 9. Commission aid has been suspended in the past, as happened with Cameroon under the 9th EDF, and with Guinea-Bissau, Malawi and Chad.

It is important that political dialogue with a country be conducted at the right level, i.e. covering all cooperation, not just a specific aid instrument. This is why political dialogue should be sufficiently broad in scope, so that it is not reduced to a few specific conditions attached to an individual programme. This dialogue must also be coordinated between the Commission and the Member States at the most appropriate political level.

3 – Disbursements of budget support often account for relatively large amounts of partner countries' budgets, and so send strong political signals. The same goes for the timing of disbursements, which may significantly influence the functioning of the State since the amounts are entered in the national budget and are necessarily part of the domestic budget timetable. The choices about disbursements and timing lie with the Commission alone and emerge from technical appraisals of financing requirements and the most suitable timing in relation to the domestic budget timetable.

They can be adjusted or adapted to stop them being used for political ends (i.e. delaying payments in the run-up to elections so as not to influence an election campaign). Transparency in decision-making and rigour in management are essential for the Commission's credibility and reputation.

6.2. Fragile states, a special case

For countries emerging from conflict or crisis the Commission has displayed openness while also demanding that eligibility criteria be met. The very nature of the situation means that the risks are higher in such countries. With the International Monetary Fund (IMF), the Commission has been the leading donor in giving support to new governments such as that of Madagascar.

In such cases it has made sure that there are good prospects of adequate microeconomic stability and obtained confirmation that the government is making real efforts to master the budgetary situation. The Commission bases its judgment on the assessments of the IMF, which has developed specific instruments for this type of situation. It is in such situations that the close and ongoing coordination with the IMF is undoubtedly most needed.

Concerning the quality of public-finance management, the Commission bases itself on prior assessments of the situation carried out by itself or by other donors (often the World Bank) and an assessment as to whether the government is giving clear signals that it intends to undertake serious reforms.

In such cases, where the risks are higher, where there is less trust and where experience has shown that even positive signals might not be translated in practice, the Commission opted for short-term aid (maximum one year). This gives us an opportunity over this transition period to check that the conditions for more normal support (often over three years) are in place.

Without clear signals in these two areas the Commission could well be accused of not upholding the Cotonou criteria.

European Commission

Budget support : 'A question of mutual trust'

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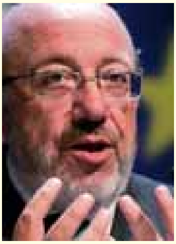
Budget support is controversial. But the debate about this form of aid is vital because it goes to the heart of the principles which lie behind our development policies.

This booklet, authored by Louis Michel, European Commissioner for Development and Humanitarian Aid, and with a foreword by Jean Ping, President of the Commission of the African Union, aims to respond to the numerous questions raised by budget support as an instrument for development. It stresses that the instrument is modern and well adapted to the current challenges of development cooperation — in particular those of ownership, transparency, predictability and effectiveness.

This booklet explains why budget support is in fact the best means of drawing up a genuine contract of confidence between partners for development.



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