

### Budget support in the EC's development cooperation

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## Budget Support in the EC's Development Cooperation

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## Budget Support in the EC's Development Cooperation

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## Preface

The present study on the European Commission's provision of budget support is based on a report prepared for the German Federal Ministry for Economic Cooperation and Development (BMZ) and submitted to the ministry in January 2005. A comprehensive analysis of the EC's budget support had become necessary because, among other things, the way in which the instrument is handled had come in for criticism from various quarters in Germany. The present study works out the central elements of the EC's budget support concept, examining it in terms of the objectives envisaged for and the risks entailed by budget support. The study furthermore looks into whether and to what extent the concept is in fact being implemented in the EC's budget-support programs. The study's aim is to assess the EC's performance as a donor in the provision of budget support.

In preparing the study, the author evaluated 30 financing proposals for budget support as well as a comprehensive body of other documents and conducted numerous interviews, with, among others, partners at the Directorate General for Development (DG DEV) and the EuropeAid Cooperation Office (AIDCO), the German Federal Ministry for Economic Cooperation and Development (BMZ), the GTZ, the KfW, and the GFA. The author also took two field trips to Ethiopia and Mozambique in order to analyze some of the initial experiences gained in program implementation. She would like to take the present opportunity to extend her heartfelt thanks to her many interview partners as well as to the representatives of the European delegations in the two countries named; without their active cooperation this study would not have been possible.

In essence, the following text reflects the state of the information available in January 2005. In a small number of cases the text has been updated or altered to render it more precise.

Bonn, August 2005

Petra Schmidt

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## Abbreviations

AIDCO	EuropeAid Co-Operation Office
AKP	African, Caribbean and Pacific States
ALA	Asian and Latin American States
APR	Annual progress review
BMZ	Federal Ministry for Economic Cooperation and Development / Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung
BWI	Bretton Woods Institutions
CAR	Central African Republic
CFAA	Country Financial Accountability Assessment
CIDA	Canadian International Development Agency
EC	European Commission
CPAR	Country Procurement Assessment Report
CSP	Country strategy paper
DAC	Development Assistance Committee (OECD)
DANIDA	Danish International Development Agency
DC	Development cooperation
DCI	Development Cooperation Ireland
DFID	United Kingdom Department for International Development
DG DEV	Directorate General for Development
DG RELEX	Directorate General for External Relations
EDF	European Development Fund
EU	European Union
FC	Financial cooperation
GTZ	Gesellschaft für technische Zusammenarbeit
HIPC	Highly indebted poor countries
IDA	International Development Association
IMF	International Monetary Fund

JDP	Joint donor program
KfW	Kreditanstalt für Wiederaufbau
MDGs	Millennium Development Goals
MEDA	Mediterranean Counterpart Countries
MFS	Macrofinancial support
MoU	Memorandum of Understanding
MTEF	Medium Term Expenditure Framework
MTR	Mid-term review
NIP	National indicative program
NORAD	Norwegian Agency for Development Cooperation
ODA	Official development assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Cooperation and Development
PAF	Performance assessment framework
PBA	Program-based approaches
PGF	Program-based joint financing
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PFM	Public financial management
PRBS	Poverty reduction budget support
PRGF	Poverty Reduction and Growth Facility
PRS	Poverty reduction strategy
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
ROSC	Report on the Observance of Standards and Codes
SAF	Structural adjustment facility
SEC	Secretariat General
SIDA	Swedish International Development Co-operation Agency
SMART	Specific, measurable, accepted by all involved, realistic, timed

SPA	Strategic Partnership with Africa
SWAP	Sector-wide approaches
TC	Technical cooperation
UN	United Nations
UNDP	United Nations Development Programme



## Executive summary

In recent years budget support has become an increasingly important instrument in the European Commission's development cooperation (DC). A clear-cut rise in the use of budget support has been noted above all in the Commission's cooperation with ACP countries. Between 2000 and 2004 commitments for budget-support operations more than doubled, recently reaching a level of nearly 21 % of new European Development Fund (EDF) commitments. Furthermore, the Commission has announced that it will further increase or at least maintain the volume of budget support. By the end of 2003, 33 of the 77 ACP countries had received EC budget support.

Provision of budget support is a contentious issue in the international debate on development cooperation (DC). While its proponents argue that the departure from the project-based approaches of the past has served to boost ownership and improve the effectiveness, efficiency, and significance of DC, its critics point to the high risks involved in providing budget support. In view of inadequate public financial management (PFM) systems in most recipient countries, they note, it is impossible to rule out substantial misuse or misappropriation of DC funds.

Against this background it has become evident that, taken by itself, the transition to budget support cannot offer any guarantee of more effective and efficient development cooperation. On the one hand, the success or failure of the instrument depends on recipient governments' competence in policy formulation and strategy development as well as on the political parameters in partner countries. On the other hand, it is the responsibility of donors to undertake whatever efforts they can to coordinate their contributions with partner programs with a view to realizing the potential benefits of budget support and to put measures in place to effectively assess and limit existing risks. This has served to center the discussion on the operational design of budget-support programs.

### *The transition to budget support in EC development cooperation*

As one of the world's largest donors, the EC constantly sees itself faced



with the challenge of optimizing the efficiency and quality of the development assistance it provides. Evaluations of Community development instruments and programs conducted in the late 1990s revealed a number of performance-related weaknesses. At the same time, the international development debate was increasingly concerned with new forms of DC. due to growing pressure to improve the efficiency and effectiveness of DC in a situation marked on the one hand by a lack of success in efforts to reduce poverty and on the other by scarcity of DC funds.

It was in particular the project approach adopted by many donors that was criticized as inefficient for not being aligned with coherent national reform strategies, for generating little ownership on the partner side, and for giving rise to high transaction costs for partners and donors alike. More and more thought is now being given to the possibility of counteracting these negative effects by focusing more on program-based approaches (PBAs). Program-based approaches represent direct and coordinated support for a locally owned development strategy or program, relying mainly on existing partner structures to relieve the strain on scarce partner-country capacities and to reduce transaction costs. One way to achieve this is by providing budget support.

Communications of the European Council and the European Commission (EC) in 2000 clearly indicate the Community's will to support partner programs and to be guided by them. Since then the EC has pursued a strategy involving a departure from projects and a transition to PBAs, and in particular to budget support. In the EC's view, general budget support is the most efficient modality of aid delivery in order to reduce poverty and generate sustainable economic growth Accordingly, general budget support is provided principally to support macroeconomic policies and comprehensive poverty-reduction strategies (PRSs) of partner countries.

Macroeconomic budget support is the default mode of Community budget support (ahead of sector budget support), and the approach is replacing the structural adjustment support of the 1990s. The latter was marked by substantial weaknesses, in particular as far as partner country program ownership, improvement of social service delivery for the poor, and poverty reduction were concerned. In the form in which it is operated today, budget support is focused primarily on effecting real

improvements for disadvantaged population groups and on making concrete progress in poverty reduction. Budget support may thus be seen as a reflection both of the international debate and of Community experience with structural adjustment support.

*Eligibility criteria for budget support*

The EC, one of the main proponents of budget support, itself concedes that the instrument entails risks, although the EC notes at the same time that this applies for other forms of DC as well. Many of these risks, it adds, can be predicted and controlled by restricting budget support to countries that meet certain eligibility criteria. In its development cooperation with the ACP countries the EC conditions budget support on the following basic eligibility criteria:

- There must be macroeconomic stability in the recipient country. As evidence, the country must have adopted and be implementing a macroeconomic program supported by a major international donor. Generally speaking, this will be linked to a loan from the International Monetary Fund's (IMF) Poverty Reduction and Growth Facility (PRGF).
- There must be a clear political will in the recipient country to reduce poverty. Implementation of a Poverty Reduction Strategy Paper (PRSP) or some other poverty reduction strategy is deemed reasonable proof.
- The recipient country must accept progress assessment based on performance indicators.
- Sufficiently transparent, efficient, and effective public financial management systems in the recipient country are required.

These eligibility criteria are fundamentally in line with the preconditions set by other donors for budget support. In view of the high fiduciary risks associated with budget support, the fourth criterion is particularly relevant to ensuring that the funds provided are used in appropriate ways. The EC does not demand a flawless system of public financial management, however. Instead of serving as an exclusion criterion, weaknesses in public financial management are seen as a challenge to

be addressed in connection with the provision of budget support. This view is derived from the logic of program-based approaches, the aim of which is precisely to strengthen existing partner capacities and to promote the development of efficient administrative structures. Increasing the transparency, effectiveness, and efficiency of public financial management is thus at the same time both the condition for and the objective of budget support.

### *Key characteristics of the EC's budget-support concept*

With a view to ensuring that its eligibility criteria are met and that the potential benefits of budget support are fully utilized, the EC developed a comprehensive program concept for budget support and incorporated it in the budget-support guidelines it adopted in 2002. The EC's budget support is marked by the following central characteristics:

- As a rule the EC's budget support is direct and untargeted, i.e. the support provided is channeled directly to the recipient government's single treasury account for budget implementation and is not earmarked for any specific use.
- The EC's budget support programs are normally designed for three years in order to increase predictability. EC budget support is disbursed in several tranches, with a distinction made between fixed and variable tranches. Normally, a fixed and a variable tranche will be released each financial year. Disbursement is conditioned on the implementation of a macroeconomic reform program and on good results on performance indicators, respectively.
- The aim of budget support is to assist partner countries in implementing their PRSPs. This requires the programs to be aligned materially and procedurally to national PRSP and budget calendars.
- The ECs budget support replaces traditional ex ante conditionality with performance-based ex post conditionality. The link between performance and disbursement is established through a gradual disbursement mechanism.
- Priority is accorded to overall assessment and improvement of partner public financial management systems.

- In this respect donor coordination has become more important than ever before.

*Application of the guidelines in the course of program implementation*

A conclusive evaluation of the way in which the EC's budget-support guidelines have been implemented will only be possible once programs have been in operation for a number of years. The same applies for anticipated benefits, such as increased ownership, reduction of transaction costs, etc. However, the financing proposals on budget support negotiated and approved by the EDF provide some first indications on the use of the guidelines. As regards the key characteristics, the following picture emerges:

- The transition from indirect, targeted budget support to direct and untargeted provision has now been concluded. All budget support programs approved by the EDF in 2003 have been direct and untargeted.
- There is a clear-cut trend toward long-term programs. A three-year period has been set for all budget support programs approved in 2003. This serves to increase predictability and contributes to continuous reform processes in partner countries.
- The model based on fixed and variable tranches is now generally accepted. In 2003, for the first time, all EC financing proposals for budget support provided for disbursement in the form of fixed and variable tranches. In 2003, nearly 50 % of programmed funds were earmarked for the variable "performance bonus." The other half of these funds is disbursed in fixed tranches.
- There is scope to improve the alignment of budget support to the PRSP and budget process. This applies in particular for the variable tranche, which is often calculated only after the government's budget has been prepared. Also, many tranches are disbursed not at the beginning but toward the end of the financial year. However, insufficient alignment of budget support to budget calendars is not an exclusive problem of the variable-tranche model. It is just as likely to be due to insufficient dovetailing of the PRSP and budget processes in recipient countries on the one hand as well as to the

generally inadequate alignment of donor support to national processes on the other.

- The need to materially align budget support to partner PRSs calls for program conditionalities that are derived from national strategies. Thus far the EC's conditionalities have not been comprehensively harmonized with national goals and objectives, a fact which is due, among other things, to difficulties partner countries have in formulating appropriate PRS indicators.
- The use of performance-based ex post conditionality is making good headway, though there would be room to expand it. Even in 2003 programs were still being approved that conditioned disbursement of the fixed tranche not only on macroeconomic reform programs but on other policy measures as well. In addition, the introduction of performance-based elements in the variable tranche does not mean that all indicators are outcome indicators: The problems involved in defining outcome indicators for public financial management make it appear unlikely that process conditionalities will be abandoned for the variable tranche, and in fact this would not be recommendable, either.
- Use of the system of graduated disbursement as a means of linking performance and payment has proven its worth in practice. It has been found practicable to condition disbursement on a balanced set of goals and objectives that neither strain nor underchallenge partner capacities. In the years 2001 and 2002 an average of 70 % of the maximum amount of variable tranches was disbursed. As experience has shown, the variable tranches work in favor of a more pronounced outcome orientation among partners.
- There is still considerable room for improvement as regards appraisal of public financial management systems. More attention should be devoted to the possibilities of both ex ante and continuous assessment of partner PFM systems. The same goes for the use of compliance tests prior to and during program implementation, a practice that has thus far been provided for in only a very limited number of programs.

### *Future challenges*

Notwithstanding certain discrepancies between program design and implementation, which should be further reduced, the following areas are turning out to be crucial to the success of the EC's budget-support programs:

- The importance of public financial management for successful poverty reduction on the one hand and the need to limit fiduciary risks on the other are now widely recognized. Numerous ACP countries, with the support of donors, have started to implement comprehensive reforms designed to incrementally improve their public budgets and financial management systems. This is a complex and long-term process, and some recipient countries are still struggling with substantial weaknesses as regards the transparency, effectiveness, and efficiency of their public financial management. It is the task of the donors, and thus of the EC as well, to continue to provide support for the implementation of these reforms, and to do so in the framework of concerted donor action. This calls for a continuous process of assessment and reporting on progress on reforms on which financing decisions and targeted technical support can be based.
- The EC's performance-based budget-support concept hinges on sound data and indicators that can be used to measure progress in poverty reduction and the provision of social services. Even after recipient countries have devoted two or three years to the implementation of their PRSPs, the PRS monitoring systems in numerous countries are still at the design stage. It would, therefore, be important to undertake targeted efforts to ensure that sound monitoring is conducted; these might include e.g. support for the statistics departments of line ministries and agencies. Sound monitoring systems are the only reliable way to systematically identify weaknesses in the implementation of poverty-reduction programs and to consistently align budget-support to partner programs.
- Despite considerable progress, donor coordination in the framework of PBAs remains a challenge. This goes in particular for the coordination of program conditionalities. As initial experiences in-

- dicade, the EC is willing to relinquish some of its influence in favor of a coordinated approach. Even so, with its outcome-oriented conditionality the EC is pursuing an approach that has received only partial backing by many other donors, including in particular the World Bank, which bases its Poverty Reduction Support Credits (PRSCs) on policy measures (prior actions). One main concern here is to avoid transaction costs for recipient countries and to coordinate conditionalities, e.g. by embedding different donor concepts in a common policy matrix.
- Provision of budget support in no way lessens the need of technical cooperation (TC). In partner countries, implementation of national strategies and reform agendas is often undercut by capacity bottlenecks at the implementation level. It should, though, be noted that support for comprehensive reforms places new demands on TC that in part differ substantially from those involved in a project-based approach. Thus far the debate in the EC on PBAs has mainly been concerned with the instruments of financial cooperation in the form of sectoral or general budget support. With the aspect of sustainable partner capacity-building in mind, the formulation and implementation of flanking TC measures should be accorded greater attention, without losing sight of the need for an approach closely coordinated with other donors.

### *Conclusions for German development cooperation*

Conclusions for German DC can be drawn in two areas: On the one hand, Germany, as an EU member state, is directly involved in EC budget support. On the other hand, Germany, as a bilateral donor, must seek to define a position of its own toward EC budget support.

As a EU member state, Germany has a voice in deciding on EC budget support approvals, prior to which it receives all financing proposals for comment. If they are to review these financing proposals on budget support in a more targeted way, the staff of both the BMZ and the German implementing agencies must have sound knowledge of the EC's budget support concept. Particular attention should be accorded to assessing the eligibility criteria that a partner country is required to meet to qualify for budget support. Ultimately, this assessment has implica-

tions for bilateral German DC, since it would be difficult to question a country's eligibility for budget support at the bilateral level once it has been deemed eligible for budget support at the supranational level.

In contrast to the more general eligibility decision, assessing the quality of individual program elements of the EC's budget-support financing is only possible and reasonable on the basis of specific country knowledge. In particular, the task of assessing indicators and targets requires information that goes beyond knowledge of the EC's financing proposals, and acquiring such data is often a costly and time-consuming effort. The desire to assess, and if need be to influence, the design of individual programs should therefore be weighed critically with a view to input and yield.

Unlike program approval, program implementation is not a subject addressed at EDF meetings. If member states are to have at least rudimentary knowledge of program implementation, it would make sense for disbursement data to be provided periodically (e.g. semiannually), particularly as concerns data regarding the calculation of the variable tranche. Germany should seek to ensure that the EC in fact makes this information available.

As a bilateral donor, Germany should in the future look into the possibility of cooperating more closely with the EC. In donor groups the EC has proven to be a reliable and competent lead partner in the field of budget support. The criteria on which it bases its provision of budget support are in line with those of other donors, and as a general rule these criteria are conscientiously observed. Viewed against this background, it would be reasonable to support an enlargement of Germany's engagement to include cofinancing of EC budget support programs. At present the German TC/FC guidelines provide only for cofinancing of the World Bank's PRSCs. German participation in multidonor budget support groups without a close link to a PRSC is not formally intended, though in it would be practice possible after consultation with the ministries concerned. Cofinancing of EC budget-support programs in terms of PRSC cofinancing is neither mentioned in the TC/FC guidelines nor practiced.

However, it would be important to examine whether and to what extent



the concept of cofinancing might be abandoned in favor of an autonomous participation of German DC in budget support programs. In the view of political decision-makers, it is in particular the high fiduciary risks involved in the provision of budget support that speak against any enlargement of general budget support and for restriction to PRSC cofinancing. Despite the assumed risks, this reserve must be regarded with a critical eye in view of the major leverage effects that an individual donor can achieve with the instrument of budget support.

What concrete shape should be given to German participation in donor groups, and whether delegated cooperation in the sense of a closer alignment to the EC's budget-support program might prove reasonable – these are questions that would have to be answered on a case-by-case basis. Against the background of the EC's experiences, we can derive the following recommendations for German DC:

- Even for “small” budget-support donors it is important to reflect on possible links between disbursement and performance and to seek to develop an adapted, graduated system of allocation.
- Viewed against the background of the need to improve the efficiency and effectiveness of aid, it would appear reasonable to concentrate on performance indicators. Clearly measurable performance-based conditionalities contribute to more objective disbursement decisions.
- However, the choice of performance indicators and the evaluation of goals and objectives set by recipient governments call for active participation in discussions bearing on developments in the sectors concerned. One question that needs to be clarified is whether German DC is in a position to mobilize the necessary capacities on the ground, or whether – e.g. – it might be more reasonable to adopt, to one extent or another, the indicators used by the EC.
- In order to take part effectively in the policy dialogue and accompany reform processes in recipient countries, it would be recommendable to strengthen German DC on the ground by developing expertise on the PRSP process, public financial management, and macroeconomic issues in recipient countries. Together with the BMZ, the German implementing agencies should develop concepts

suited to adapting their external structures to the new challenges. This goes in particular for the priority partner countries of German DC.

- The task of providing comprehensive assessments of recipients' public financial management systems requires donors to develop expertise. German DC should thus intensify its efforts to build capacities in the field of public budgets and financial management, not least with a view to becoming involved in important thematic fields within donor groups.



## 1 Introduction

There is an international consensus that the Millennium Development Goals (MDGs) can only be achieved if both official development assistance (ODA) is increased sharply and development cooperation and its instruments and modalities become more efficient and effective. With a view to increasing the efficiency of ODA, aid donors are increasingly providing direct and coordinated support for broad political programs and strategies in recipient countries (program-based approaches / PBAs), with existing partner structures being used to relieve the strain on partner-country capacities and to reduce transaction costs. National budgets – and outside support for them – figure prominently in the debate. One way to do this (to support budgets) is to provide budget support or other joint financing mechanisms.

The European Commission is one of the most important advocates of budget support – along with the World Bank, the UK, and the Netherlands. Since 2000 the Commission has pursued a strategy involving a departure from projects and a transition to PBAs, and in particular to budget support.

*„The Commission considers budget support as one of the most efficient modalities of aid delivery and the one that is most likely to significantly contribute to growth, improving financial management, reducing poverty and economic restructuring.“<sup>1</sup>*

The use of budget support has increased markedly in recent years, above all in development cooperation with ACP countries. According to recent figures, budget support has accounted for over 23 % of new commitments.

While the proponents of budget support argue that the shift away from the project-based approaches of the past serves to boost ownership and raise the efficiency and significance of DC contributions, its critics point to the high risks associated with the provision of budget support. In view of inadequate public financial management (PFM) systems in most recipient countries, it has been noted, it is impossible to rule out substantial misuse or misappropriation of DC funds. Even its main proponents concede that provision of budget support entails risks, although they note at the same time that this applies for other forms of DC as well. Many of these risks,

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1 EC (2004a, 4).

they add, can be predicted and controlled. In the end, it is noted, a weighing of the risks and chances of budget support indicates that the instrument offers the potential to provide a substantial contribution to reaching the MDGs in a situation of scarce resources.

Against this background it has become evident that, taken by itself, the transition to budget support cannot offer any guarantee of more effective and efficient development cooperation. On the one hand, the success or failure of the instrument depends on recipient governments' competence in policy formulation and strategy development as well as on the political parameters in partner countries. On the other hand, it is the responsibility of donors to undertake whatever efforts they can to coordinate their contributions with partner programs with a view to realizing the potential benefits of budget support and to putting measures in place to effectively assess and limit existing risks. This has served to center the discussion on (the) operational design (of) budget-support programs.

The present study looks into the budget support provided in the framework of Community development aid.<sup>2</sup> The study works out the central elements of the EC's budget-support concept, examining them in the light of the goals they aim to achieve and the risks they entail. It furthermore looks into whether and to what extent the concept has in fact been adopted and is being practiced in the EC's budget-support programs. The aim is to evaluate the performance of the European Commission, qua donor, in the provision of budget support.

One of the reasons why it had become necessary to conduct a comprehensive analysis of the EC's budget support was that the way the instrument has been handled has come in for criticism from various quarters in Germany. In particular, two arguments are cited in this connection:

- The main reason for providing budget support is to speed up the outflow of funds.
- The EC's preparatory work for budget-support operations is not adequate and insufficient attention is paid to implementation. The result is that budget support is granted without any reasonable certainty that the eligibility criteria recognized by other donors have in fact been

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2 The aim, structure, and contents of the study follow the TOR agreed on with the BMZ; see Annex 1.

met by the recipients governments (poverty-reduction strategies, satisfactory quality of public financial management, etc.).

There is, however, little evidence to back these assertions. Nor is it clear whether this criticism is due to general skepticism toward PBAs and budget support or whether it distinguishes between the EC and other providers of budget support.

The way in which budget support is embedded in Community DC has an important role to play in evaluating these criticisms leveled at the EC. Chapter 2 of the present study for this reason takes a close look at the debate within the EC that has led to the increased use of the instrument of budget support and discusses the legal foundations on which budget support is based, checking them against the conditions set by other providers of budget support.

Chapter 3 provides an overview of the financial and budgetary scope of budget-support programs, discussing the issue in the context of the problem complex implied by the above-mentioned, alleged interest in speeding up outflows of funds. Chapter 4 then goes on to outline some of the central characteristics of the concept of budget support and to examine the extent to which these are accorded due consideration in the preparation of financing proposals on budget support. In this connection the study looks into 30 of the 50 financing proposals adopted by the European Development Fund between 2002 and 2003. The analysis focuses on two examples of budget-support programs (Ethiopia and Mozambique) with a view to gleaning some first experiences made with the instrument. Chapter 5 then sums up the study's most important findings, drawing conclusions for German DC.

The EC's provision of budget support in its DC is an issue relevant in particular in the framework of its cooperation with ACP countries. As far as the EC's other regional programs are concerned, budget support has either long since proved its value as a instrument (MEDA) or is still in its incipient phase (ALA). Other EC programs (TACIS, CARDS, Phare) provide only in part for budget support. The study for this reason concentrates on EDF financing operations, focusing in particular on general budget aids as a core area of EC budget support.

## 2 Provision of budget support in the framework of European development cooperation

### 2.1 Reorientation of European development cooperation: support for program-based approaches and emphasis on budget support

Alongside trade policy and the general political dimension, development policy is one of the three principle pillars of the European Union's external activities. The EC plays an important role in international cooperation and development assistance. Together with its member countries, the EC accounts for 65.7 % of the official development assistance (ODA) provided worldwide as well as for over two thirds of outright grants.<sup>3</sup> The European Community bears the political and financial responsibility for more than 10 % of the overall official development assistance provided worldwide, which means that that the Community has nearly doubled its percentage share of ODA since 1985.

As one of the world's largest donors, the EC constantly sees itself faced with the challenge of optimizing the efficiency and quality of the development assistance it provides. Evaluations of Community development instruments and programs conducted in the late 1990s revealed a number of performance-related weaknesses.<sup>4</sup> The Community's development-assistance system was found to be adversely affected by a number of overly complex and highly fragmented procedures. Strategies were governed more by instruments than by clearly defined priorities, and staff levels were inadequate to the task of managing the volume of funding involved. Critical comments from both the OECD's Development Assistance Committee (DAC) and other quarters confirmed this assessment, noting that Community development policy lacked a coherent strategy and sufficient focus.<sup>5</sup> This gave the impetus for a wide-ranging reform of European development cooperation that has been underway since 2000 and has extended to both the formulation of new political guidelines and a course of extensive administrative reform.

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3 As of 2003; see <http://www.oecd.org/dataoecd/42/61/31504039.pdf>.

4 See EC (1998), EC (1999), COWI (1998).

5 See OECD / DAC (1998, 12).

The core of this reorientation may be seen in the EC's communication on the European Community's development policy, which was issued in April 2000. The communication amounts to a comprehensive overall development-policy concept geared to poverty reduction. It was followed by a joint declaration by the Council and the Commission emphasizing poverty reduction as the paramount objective of Community assistance.<sup>6</sup> With a view to increasing the impact of development cooperation and overcoming the fragmentation referred to above, Council and Commission defined six priority fields of action on which future Community aid is to concentrate.<sup>7</sup> This choice of fields of action was based on two main criteria: First, they must be deemed appropriate to contribute to poverty reduction and sustainable development; second, these must be fields in which the Community enjoys a comparative advantage over other donors. Aside from this substantive focus, the intention is to improve the efficiency of development cooperation by reorganizing the procedures and modalities of external aid as well as by enhancing coordination, complementarity and coherence. Building on the statements made by Council and EC, the Community adopted, in May 2000, a detailed reform program<sup>8</sup> that found concrete expression in a program of action presented in 2001.<sup>9</sup>

The guidelines on the Community's development policy not only respond to the weaknesses of community aid, they may also be seen as a reflection of the international debate underway since the mid-1990s on a range of issues that may be summed up under the header of "aid effectiveness." In view of the lack of success of previous efforts to reduce poverty and generate sustainable growth, the discussions are now concerned with ways to boost the effectiveness of DC as well as with possible instrumental adjustments required for the purpose.

One view that figures high in the ongoing general discussion is that the project approach pursued by many donors is marred by substantial draw-

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6 See Council of the European Union (2000).

7 The priority fields of action are 1) trade and development, 2) regional integration und cooperation, 3) support for macroeconomic policies, with explicit reference to poverty-reduction strategies, 4) transportation, 5) food security und rural development, and 6) institutional capacity-building and good governance.

8 See EC (2000b).

9 See SEC (2001).



backs.<sup>10</sup> These include the low reach of "project islands," limited project sustainability once donor funding is discontinued, overly high transaction costs on both the partner and the donor side, and weak partner ownership, due for the most part to a one-sided orientation of DC contributions to donor priorities. Furthermore, donor-dominated parallel structures became entrenched and projects contributed little to building institutional and administrative capacities in partner countries. But ambitious development goals like poverty reduction and economic growth cannot be reached in the absence of effective governmental structures.

Against this background numerous recipient countries and donors have come out in favor of gearing bi- and multilateral development cooperation more to partner priorities and programs and making better use of existing structures. They see program-oriented DC and harmonization of donor contributions as a good way to boost the effectiveness, efficiency, and significance of development cooperation. There are also plans to gauge DC in terms of the results of development-related measures instead of inputs (results orientation) as well as to continuously track the poverty orientation of programs.

The communications of Council and EC clearly indicate the Community's will to support partner-country programs and to be guided by them.<sup>11</sup> In this context national Poverty Reduction Strategy Papers (PRSPs), which have now been presented by 42 countries<sup>12</sup> and are used as the basis for elaborating the EC's country strategies, serve as the most important frame of reference for development cooperation. The concept of partnership-based relationships is accorded particular importance in this connection. Government programs, and thus PRSPs as well, constitute a set of principles and lines of action that are further concretized only in the course of implementation.<sup>13</sup> One essential element of the EC's general willingness to contribute to and support such strategies is an intensive dialogue geared to ensuring coherence between the policies of a partner country and the ac-

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10 This goes above all for countries with a high ODA/GDP or ODA/budget ratio.

11 "The Community is therefore determined to support poverty reduction strategies which integrate these many dimensions and are based on the analysis of constraints and opportunities in individual developing countries." Council of the European Union (2000, 11).

12 As of December 2004.

13 See GTZ (2004, 12).

tivities of the Community as well as to providing the space needed to specify strategies in the course of their evolution. Both the Council and the Commission see the quality of dialogues with partner countries as the key to successful development cooperation and they both define the concept "partnership" as a principle of Community aid.<sup>14</sup>

Consistent support for the strategies of recipient countries also calls for new aid modalities. The debates surrounding program-based approaches have sensitized the development community to what is known as the fungibility of DC. DC is referred to as fungible when the aid provided enables partner countries to reduce their own expenditures in one place in order to use the funds for other purposes. Experience shows that project-based approaches have neither obviated the fungibility problem nor had any marked influence on partner-government priorities. Only in the framework of a partner country's overall budget is it possible to monitor whether donor funds are being used fungibly and what spending priorities a recipient country is pursuing. Many donors have therefore spoken out in favor of centering their activities on the budgets of recipient countries and seeking to influence the allocation of funds by means of cross-cutting approaches or sector programs. The financing modalities that have been proposed range from general budget support to sectoral budget aids and other mechanisms of joint financing (Fig. 1). In the international discussion joint measures are commonly referred to as basket-funding or common pools.<sup>15</sup> In the framework of joint financing a number of donors provide financial resources for a fund or pool which is administered on the basis of standardized procedures (reporting, etc.). Depending on donor-side capacities, the use to which these funds are put can be decided on by the donors, the partner concerned, or by both together – which is likely to be the normal case.<sup>16</sup>

The new orientation of the EU's development cooperation entails a shift in the set of instruments used in Community aid. The EC sees a need to concentrate on budget support and sector programming as a means of enhancing the effectiveness and quality of its development policy.<sup>17</sup> The Council

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14 See KOM (2000a, 31).

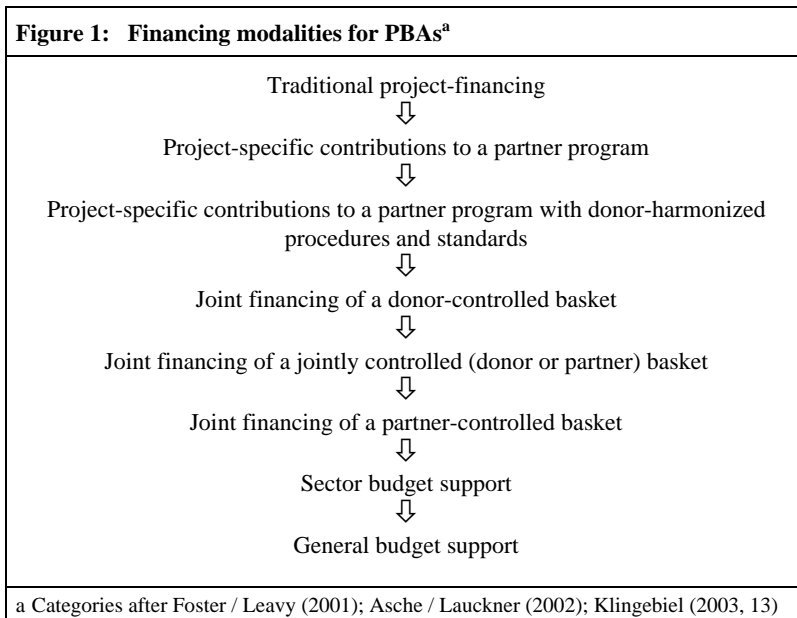
15 See e.g. World Bank (2002, 33); EC (2003b, 48 ff.).

16 See Klingebiel (2003, 8).

17 See EC (2000b, 37).

has expressly declared both direct budget support and sectoral budget aids to be the preferred instruments of Community aid:

*"The Commission has initiated a reshaping of its external aid management. This approach must have implications for Community aid instruments. The introduction of rolling programming [...] and increased recourse to sectoral support and to direct budgetary aid where the conditions so allow and where subsequent monitoring may be introduced are likely to help to lead to more efficient management and a more efficient allocation of resources."<sup>18</sup>*



Thus the EC has joined the group of donors who show a clear-cut trend toward program orientation. Many partner countries welcome this change in the thrust of DC and are expressly calling on the donor community to support their strategies by providing financing contributions for sector programs or budget support (Ethiopia, Uganda, Mozambique, and oth-

18 See Council of the European Union (2000, 8).

ers).<sup>19</sup> In recent years budget support has become an increasingly important instrument of Community aid, one used principally to support partners with their economic policies and PRSs.<sup>20</sup>

## 2.2 The transition from structural adjustment aid to macroeconomic budget support

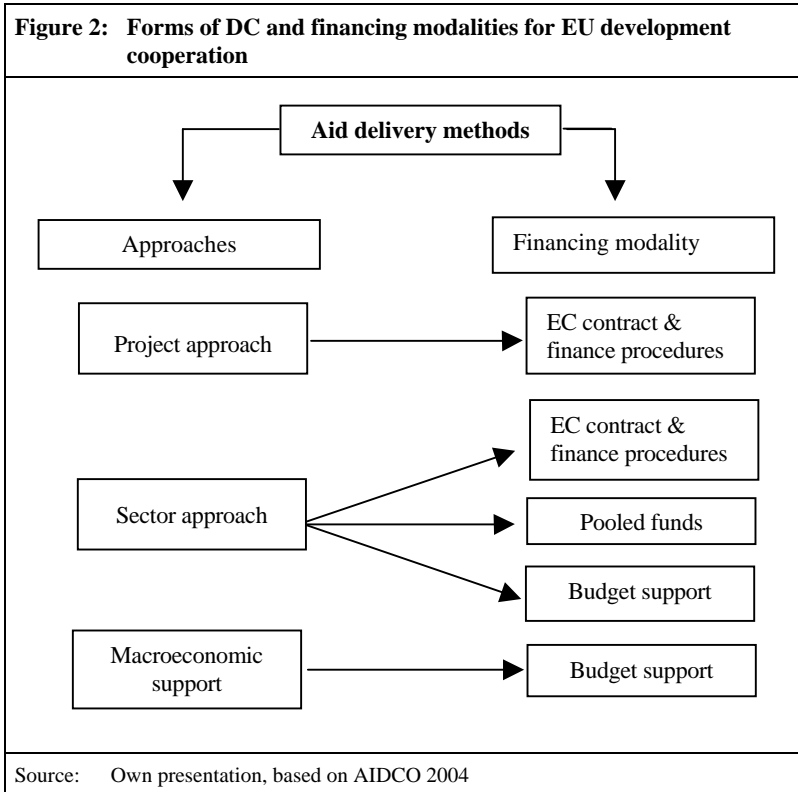
The transition to program orientation is more marked in some priority fields of Community aid than in others. One field of action that plays a particularly important role in connection with PBA and the use of budget support is "support to macroeconomic policies with an explicit link with poverty reduction strategies, in particular sector programs in social areas (health and education)". The EC generally provides budget aids to support macroeconomic programs, while projects continue to be transacted via the traditional contractual procedures and financing lines (Fig. 2). It should be noted here that the focus on macroeconomic strategies in European development cooperation is nothing new. In the early 1990s the Community provided substantial funds in support of partner-country macropolicies and structural adjustment programs.

The reason for this must be sought in proliferating economic disequilibria in numerous partner countries. In the early 1980ths many ACP countries were faced with sizable budget and balance-of-payments deficits, which they financed by running up foreign debts not commensurate with their growth prospects. With a view to overcoming these problems and restoring economic equilibrium, the countries concerned embarked, under the aegis of the Bretton Woods Institutions, on a course of extensive structural adjustment. The intention was to reduce their deficits at the domestic (budget) and external (balance of payments) level by implementing a number of macroeconomic measures and restructuring their public expenditure. The European Community participated in this process. The 4<sup>th</sup> Lomé Agreement, whose Articles 243 to 250 provide for a support instrument for structural adjustment, created the legal basis for Community fi-

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19 The government of Mozambique has called on donors e.g. to raise the budget-support share of ODA to 60 %.

20 See OECD / DAC (2002, 1-46 f.).



nancing of economic reforms in the ACP countries.<sup>21</sup> Since then support for structural reforms has become an integral component of the Community's technical and financial cooperation with partner countries in the ACP and MEDA regions.<sup>22</sup> By the end of 2002 the Commission had made payments totaling € 2.3 to 42 ACP countries in support of reforms on

21 The 4th Lomé Agreement (Lomé IV) was signed on 15 December 1998 and took effect in 1990 for a period of 10 years. In addition, a five-year supplementary financial protocol was adopted for the 7th EDF. At mid-term, in November 1995, Lomé IV was revised and enlarged to include an additional five-year financial protocol for the 8th EDF.

22 Support for structural reforms played a lesser role in cooperation with Asian and Latin American countries (ALAs) in the 1990s, and the current ALA Regulation (1992) does not provide for a structural-assistance instrument.

which they had reached agreements with the BWIs. Between 1992 and 2000, in the framework of the MEDA program, the Community earmarked a total of €600 for SAFs in the Mediterranean countries.<sup>23</sup>

The experiences made with the Community's structural adjustments aids are quite complex. There is no doubt that Community programs have contributed to consolidating the macroeconomic equilibrium in partner countries and supported them in the process of structural adjustment. Even so, substantial weaknesses have been identified, in particular as far as partner-country program ownership, improvement of social services for poorer population groups, and poverty reduction are concerned.<sup>24</sup> Similar deficits were noted for the structural adjustment loans provided by the IMF and the World Bank. In 1999 it was disappointment over the lack of success in the field of poverty reduction that gave the impetus to develop the PRSP concept. Comprehensive poverty-reduction strategies were made into a core instrument of debt relief in the framework of the highly indebted poor countries (HIPC) initiative. The BWIs at the same time conditioned their concessional lending on the preparation of PRSPs by partner countries. In replacing its former structural adjustment credit with the new Poverty Reduction Support Credit (PRSC), the World Bank raised poverty reduction to the level of an objective and criterion of the success of its programs. The IMF in turn replaced its expanded structural adjustment facility with its PRGF.

The EC was took part in the discussions of the most important donors and adapted its aid to the altered perspective of and the new challenges facing the ACP countries. Based on an EC document reviewing the prospects of Community support for structural adjustment,<sup>25</sup> the Community has, since 2000, granted budget support geared more strongly to effecting real improvements for disadvantaged population groups and to achieving progress in poverty reduction. The EC's comments on support for structural adjustment were supplemented by assessments provided by the Council and the

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23 See Europäischer Rechnungshof (2002, 12 f.).

24 See Rat Entwicklung (2000, 11); Europäischer Rechnungshof (2001b).

25 "Communication from the Commission to the Council and the European Parliament: Community support for economic reform programmes and structural adjustment: review and prospects," 04.02.2000, EC (2000) 58 final.

European Court of Auditors.<sup>26</sup> All share the view that the handling of the instrument was in need of adjustment in view of a more pronounced program orientation and the associated, growing role played by budget support in this connection. With the Cotonou Agreement and the MEDA 2 Regulation, the European Union initiated a new era in its support of economic reforms in partner countries, defining the legal framework for the provision of budget support.

### 2.3 Legal basis and preconditions for the provision of budget support

The framework agreements on cooperation with partner countries (MEDA 2 Regulation and Cotonou Agreement) stipulate the eligibility criteria for budget support. One exception is the ALA Regulation,<sup>27</sup> which makes no explicit reference to macroeconomic and budget support. The basis for support of macroeconomic reform programs in the ALA countries is therefore the Council's recommendation of 18 May 2000, which comes out in favor of support for economic reforms in all developing countries, including the ALAs. Furthermore, the Commission's Communication on Community support for economic reform programmes and structural adjustment<sup>28</sup> which recommends the use of budget support, forms the basis for Community support of macroeconomic reforms in Asia and Latin America.

The partnership agreement between the EU and 77 African, Caribbean, and Pacific countries, adopted in June 2000, is exemplary for the reorien-

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26 Council - DEVELOPMENT (2000): Protocol of the 2236rd Council meeting – DEVELOPMENT – 8571/00 (presse 156), Brussels 18.05.2000; European Court of Auditors (2001a): Special Report No 5/2001 on counterpart funds from structural adjustment support earmarked for budget aid (seventh and eighth EDFs), together with the Commission's replies (2001/C 257/01); European Court of Auditors (2002): Special Report No 1/2002 concerning macrofinancial assistance (MFA) to third countries and structural adjustment facilities (SAF) in the Mediterranean countries, together with the Commission's replies.

27 See Council of the European Union (1992).

28 See KOM (2000c).

tation of Community aid in the sense of program orientation.<sup>29</sup> The agreement underlines the equality- and partnership-based nature of the Community's cooperation with the ACP countries and provides for the use of budget support as a flanking measure for macroeconomic and sectoral reforms.<sup>30</sup>

The Cotonou Agreement stipulates that partner countries must meet the following preconditions to be eligible to receive budget support.<sup>31</sup>

- There must be macroeconomic stability in the recipient country. As evidence, the country must have adopted and be implementing a macroeconomic program supported by the Bretton Woods institutions. Generally speaking, this will be linked to a loan from the International Monetary Fund's (IMF) Poverty Reduction and Growth Facility (PRGF).
- There must be a clear political will in the partner country to reduce poverty. Implementation of a Poverty Reduction Strategy Paper (PRSP) or a comparable strategy for poverty reduction are deemed reasonable proof.
- Sufficiently transparent, efficient, and effective budget management in the recipient country is required. The government must have a clearly articulated will to embark on reforms and improve public financial management.
- The recipient country must accept evaluation of its progress on the basis of performance indicators.

Considering the support provided thus far by the Community and the course of the international discussion, these conditions must be seen as reflecting a transition of Community aid to a second generation of reforms. The cross-cutting economic objective continues to be stable macroeconomic frameworks in partner countries. "Macroeconomic budget support underpins structural reforms intended to ensure the viability of growth and

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29 The central objectives defined in the agreement include poverty reduction, sustainable development, a step-by-step integration of the ACP countries into the world economy; these objectives had already been set out the Maastricht Treaty as goals of European DC.

30 See Cotonou Agreement, Art. 67 and Art. 69 (see Annex 2 of the present study).

31 See EC (2004a, 3).



equality."<sup>32</sup> Consolidation of a macroeconomic framework conducive to economic growth is seen as a necessary condition for reducing poverty. It deserves to be emphasized that for the Commission there can be only one macroeconomic reform program in place in one given country. This is the reason why Community aid provided in the framework of structural adjustment should be sufficiently coordinated with other donors, in particular with the BWIs and the EU member countries. Support is provided only for programs recognized and, if appropriate, backed by the most important multilateral donors. The EC's concern here is to assume, alongside the BWIs, a greater role in the reform dialogue with partner governments, without losing sight of the objectives and special features of Community aid.<sup>33</sup> In the past the EC has played a particularly significant role in the international debate on the social impacts of economic reforms, to which it has made some important contributions.

By requiring partner countries to work out national PRSPs or comparable strategies, the Community has moved poverty reduction to the center of macroeconomic reform programs. Its emphasis on partner-owned poverty-reduction strategies may be seen as consistent with the call for a more pronounced internalization of programs. Poverty reduction is not only a goal in its own right, it is also a prerequisite for obtaining support of the population for reforms that are often painful.<sup>34</sup> For the EC sustainable development centers on the sectors health and education, which are accorded greater attention in nearly all Community macroeconomic budget-support programs. However, it will only be possible to achieve real improvement in social services if key sectors are coordinated with the macroeconomic framework in which they operate. It is for this reason both efficient and effective to include them in economic reform programs from the very outset.<sup>35</sup>

For donors, a sound and efficient public financial management of the kind explicitly referred to in the Cotonou Agreement is a highly relevant factor

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32 AIDCO / DEV / RELEX (2002, 15).

33 See KOM (2000b, 33).

34 See KOM (2000b, 2).

35 See KOM (2000a, 29).

because of the high fiduciary risks<sup>36</sup> involved in the provision of budget support. Article 61(2), § a), of the agreement conditions budget support on public financial management in partner countries that is "sufficiently transparent, accountable and effective." The article is generally interpreted as meaning that a minimum of transparency, effectiveness, and efficiency must be given in the public financial management of partner countries. However, far from being an exclusion criterion, weaknesses in public financial management are seen as a challenge to be addressed in connection with the provision of budget support. This view is derived from the logic of program-based approaches, the aim of which is precisely to strengthen existing capacities and to promote the development of efficient administrative structures. Increasing the transparency, effectiveness, and efficiency of public financial management is thus both the condition for and the objective of budget support.<sup>37</sup> Accordingly, EC budget-support programs are designed to help partner countries build the capacities they need to develop an efficient administration as well as suitable control mechanisms.<sup>38</sup> But improvements in public financial management are only possible when necessary reforms are accepted, supported, and managed by partner countries. This is why the European Commission cites the will to reform and improve partner financial administrations as a criterion for the provision of EC budget support in ACP countries.

One factor of great importance in this regard is the conditionalities attached to budget support. The point of conditionalities is to assess public financial management and to keep track of necessary improvements. In view of the fact that traditional conditionality typically imposed for structural adjustment programs proved to have substantial weaknesses, the Commission has replaced its conditionality policy with a performance-based ex post conditionality. The new conditionality centers on the development of performance indicators that are used to assess progress in partner countries. The adoption of this eligibility criterion is in line with the Community's fundamental concern with enhancing the outcome orientation of DC, which has now become a Community priority.

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36 The term refers to the risk that funds provided may not be used efficiently for the purposes for which they were intended or that they might be misappropriated. See GTZ / KfW (2003, 21), DFID (2004, 2).

37 See Leiderer (2004, 3 f.).

38 See Rat Entwicklung (2000, 13).

Unlike the Cotonou Agreement, the MEDA 2 Regulation does not explicitly address the quality of public financial management. The requisite eligibility criteria refer exclusively to the implementation of a BWI-approved reform program, the economic situation of the country in question, and sector reforms in general (Annex 1). In practice, however, provision of budget support in the Mediterranean countries as well is conditioned on their implementation of cross-cutting poverty strategies and development of their systems of public financial management.<sup>39</sup>

The eligibility criteria for budget support apply for both macroeconomic and sector budget support. The following section looks into how the EC defines these types of budget support.

## 2.4 Macroeconomic and sector budget support

Depending on the use for which it is intended, the Commission breaks budget support down into three different types (Fig. 3). Accordingly, macroeconomic budget support is provided, first, in support of economic reforms and poverty reduction, second, as emergency aid for purposes of stabilization and rehabilitation, and third, as complementary ad hoc aid to mitigate short-term export fluctuations and to support regional integration projects. Both emergency aid and complementary ad hoc aid may be seen as special cases of macroeconomic budget support, whereas support for macroeconomic reforms constitutes the core of budget-support operations. It is important to distinguish between the regular instrument of macroeconomic budget support and macrofinancial support (MFS), a special instrument which is provided to EU accession countries.<sup>40</sup>

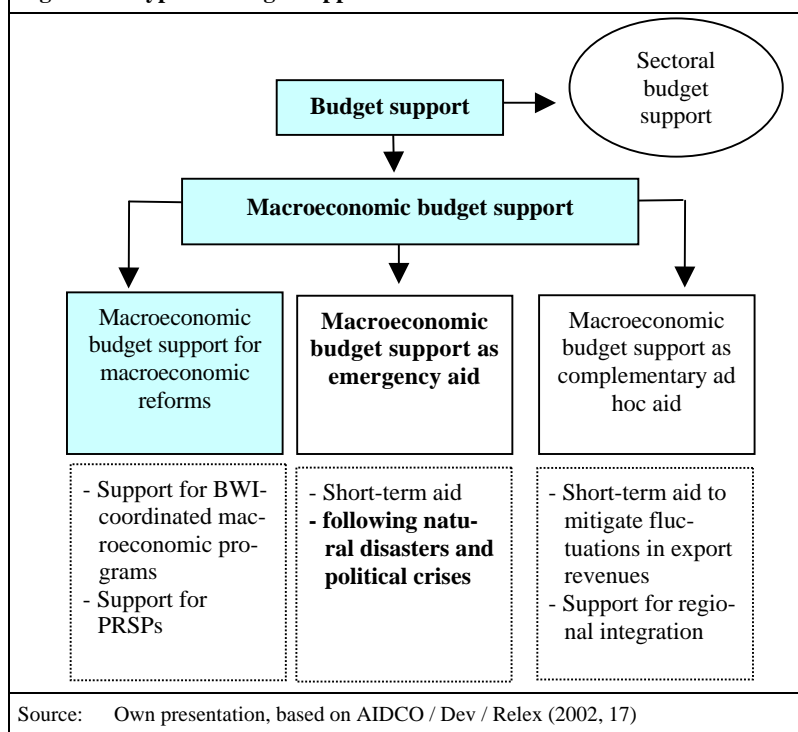
Budget support in the form of emergency aid is used to support countries that see themselves confronted with unanticipated financing bottlenecks in the wake of external or internal political or civil crises and natural disasters. A pluriannual support program keyed to long-term reforms would not be appropriate in situations of this kind. What these countries need is short-term support to stabilize their budgets and reduce their deficits at

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39 See AIDCO / DEV / RELEX (2002, 19).

40 MFS is approved through specific Council decisions based on a EC proposal. As of the year 2000, nine countries had received MFS amounting to a total volume of €822 million. See AIDCO / DEV / RELEX (2000, 15).

**Figure 3: Types of budget support in the EU's DC**



both the internal (budget) and external (balance-of-payments) levels. As a rule emergency aid consists of one-year programs linked to a plan for economic reconstruction. Unlike World Bank and IMF, the Commission has not developed any special financing lines designed to mitigate crises and instead makes use of existing financing lines.<sup>41</sup>

Complementary ad hoc supports are used to mitigate fluctuations in export revenues, and they are for the most part provided to ACP countries. In view of the fact that many ACP countries are forced to contend with underdiversified economic structures and one-sided dependence on certain agricultural goods, fluctuations in their export revenues may endanger the

<sup>41</sup> Funds from the B-envelope may be used for the ACP countries.

implementation of macroeconomic and sector reform programs. Apart from exceptional support provided for reform programs in the wake of declines in export revenues, the Community also uses ad hoc budget support as a means of promoting regional integration programs.

Budget aids provided in support of macroeconomic reforms are the core area of Community budget support. This goes back to the structural adjustment aids and the structural adjustment facility of the 1990s and, in its present form, reflects the Community's aim of improving the effectiveness of DC. In the international development discussion this type of budget support is usually referred to as general budget support.

The Commission draws a line between macroeconomic budget support and budget aids provided to help implement coherent and donor-coordinated sector policies and programs. Sector budget support is normally complementary to macroeconomic budget support, unless the countries concerned are found to have stable economic frameworks. "In practice, it is difficult to conceive of providing sector budget support in the absence of a macroeconomic reform programme."<sup>42</sup> In contrast to this approach, many donors see the introduction of PBAs as a process providing for the step-by-step development of projects extending from joint financing to budget support.<sup>43</sup> In other words, given unfavorable framework conditions in a recipient country, a fund may e.g. be set up outside the budget, whereas in countries with a satisfactory sectoral financial administration sector budget support may well prove to be the right approach prior to the point at which the transition is made to general budget support.

The sectoral budget aid provided by the EC can be used in supports of SWAPs (sector-wide approaches) or for sectoral policies bearing on food security. In the view of the Commission, a SWAP is given if the following criteria are met:<sup>44</sup> The country concerned has

- an "approved sector policy document" and an "overall strategic framework" and

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42 See AIDCO / DEV / RELEX (2000, 26).

43 See Netherlands Ministry of Foreign Affairs (2001). In the international debate the transition to PBAs is often seen as a continuum the final point on which is general budget support. See e.g. OECD / DAC (2001); Foster / Leavy (2001).

44 See EC (2003b, 8 ff.).

- an "annual budget" and a "sectoral medium-term expenditure framework."
- Donor coordination in the sector concerned is managed by the recipient country.

Aside from these criteria, many donors see a SWAP as given when a partner country has coordinated its sectoral expenditure framework with its overall budget and when the most important donors are involved in the program.

The definitions of macroeconomic and sector budget support are anchored in the EC budget-support guidelines adopted in 2002. These guidelines summarize the budget-support reforms that have been successively adopted since 2002 and approved in several EC and Council documents. They regulate the practical formulation of Community budget-support programs and provide a concept for budget-support programs that can be seen as quite detailed by international comparison.

## 2.5 The EC guidelines on provision of budget support: an international comparison

Alongside the UK, the Netherlands, and the World Bank, the European Commission is one of the most important donors to have come out in favor of budget support. This basic stance is reflected on the one hand in the rising share accounted for by program-oriented community financing in the overall portfolio of EC DC institutions and on the other by internal strategy documents that stipulate a more pronounced program orientation and specify the Community's approach. The Commission's strategy documents and guidelines on the use of budget support are an important point of departure in any attempt to determine whether its budget-support projects are in line with the standards set by other donors. However, we find here that only a limited number of institutions define any detailed criteria on the concrete implementation, monitoring, and evaluation of budget-support programs, largely restricting themselves to formulating basic principles and objectives of budget support.

The key document for the planning and transaction of EC budget-support projects is the "Guide to the programming and implementation of budget support for third countries," which was adopted in March of 2002. Inde-

pendent budget-support guidelines had become necessary because, first, the PRSP approach had altered the frame of reference for the use of budget support and, second, it was necessary to bring the instrument into line with the recommendations of the Council and the Court of Auditors and to have it reflect the innovations that were part of the Cotonou Agreement. And third, administrative reform made it necessary to restructure competences and responsibilities.<sup>45</sup>

The guidelines are based on the experiences already made with budget support and – in particular – on the Cotonou Agreement as well as on some further strategy documents that declare budget support to be an important instrument of Community aid. The guidelines are seen as a dynamic document, and the intention is to further enlarge and refine them in the light of new developments and practical experience. The criteria set out in the guidelines are furthermore complemented by a number of continuative documents, including e.g. documents on performance indicators.

Compared with the strategy documents of other donors, the EC guidelines set out in detail the modalities involved in the financing of budget support (see Chapter 4). The guidelines are designed to harmonize working methods and to strengthen internal partner capacities, and they define a concept of budget support which includes, aside from some fundamental reflections on the subject, all stages of the project cycle from project identification to project implementation and evaluation. By comparison, the guidelines of most other donors are restricted to the objectives, basic principles, and eligibility criteria on the basis of which budget support is provided.

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45 The budget-support guidelines were prepared by the Europe Aid Co-operation Office (AIDCO) and the Directorates General for External Relations (DG RELEX) and Development (DG DEV), which had been created in connection with the administrative reform referred to above. AIDCO's task is to provide for an effective and efficient administration and implementation of projects on the basis of the program planning done by the Directorates General. This means that one implementing unit (AIDCO) deals with two programming units (DG DEV and DG RELEX) that are responsible for the further conceptual development of the EC's set of DC instruments. Although at the program level there is no fundamental division between cooperation with the ACP countries on the one hand and the rest of the world on the other, DG DEV is the main unit involved in the planning of budget support with the ACP countries. See AIDCO / DEV / RELEX (2002, 7).

### *The UK*

In its white paper "Eliminating World Poverty: Making Globalisation Work for the Poor," the British government stipulates that, presupposing the existence of suitable conditions in partner countries, its FC will be transacted increasingly via national budgets. In the framework of the discussion on program-based approaches, DFID sees budget support as an especially effective instrument. "Budget support (...), either as support to the budget as a whole or as part of a SWAP, is potentially the most effective financial aid instrument in supporting the PRS core principles." DFID's orientation documents on "Poverty Reduction Budget Support" and on "Managing Fiduciary Risk when Providing Direct Budget Support"<sup>46</sup> set out the underlying strategic principles of the agency's approach.

In these documents DFID comes out explicitly for an expansion of budget support. The aim of budget support, it is noted, is to support national poverty-reduction strategies and to contribute to reaching the MDGs by increasing poverty-relevant expenditures. In DFID's eyes, an efficient use of the instrument must be predicated on the following preconditions: first, a strong partner-country commitment to poverty reduction that is monitored in a continuous dialogue between donors and partner governments. Second, partner governments are expected to commit themselves credibly to strengthening and reforming their systems of public budget and financial management. In view of the anticipated development impacts, DFID has consciously decided to accept the fiduciary risks associated with the provision of budget support.<sup>47</sup> Budget support is not provided in cases in which the fiduciary risks are seen as too high and it appears unlikely that they will become smaller during the support process. Third, the use of budget support must have clear-cut comparative advantages compared with other DC instruments.

For DFID, the advantages of budget support compared with individual projects must be seen in the ability of the former to strengthen ownership as well as to contribute to a more intensive dialogue and improved donor harmonization. The medium-term expectation is to render aid more accessible to planning (predictability) and to improve social services for poorer

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46 DFID (2002); DFID (2004).

47 "Potential development benefits justify the fiduciary risks." DFID (2004, 4).



population groups. DFID notes that the specific risks involved in budget support include above all the eventuality of an abrupt suspension of support, e.g. for reasons of human rights violations. The agency notes that other risks, including fiduciary risks or risks involved in financing prestige projects, are not specific to budget support but must be addressed for all other DC instruments as well. The DFID guidelines on budget support make no concrete statements on program design (terms, tranches, etc.).

### *The Netherlands*

Since 1998 Dutch DC has shown an observable trend toward program orientation. "The slogan 'Think micro, act macro' tries to capture the belief that policies should be based on the needs of the poor but funding should be provided at macro level tries to capture the believe that policies should be provided at macro level whenever possible and feasible and to fund only the meso or micro level whenever necessary."<sup>48</sup> The aim is to achieve a successive transition from basket funding to budget support. The strategic principles and cornerstones of the Dutch approach are set out in the "Memorandum on the relationship between macro-oriented and sectoral programme aid."<sup>49</sup> The eligibility criteria laid down for the provision of general budget support include the implementation of a macroeconomic reform program coordinated with the BWIs, good quality of macro-policies, satisfactory institutional capacities, and a poverty-oriented social policy. In view of the fungibility of the funds involved, the memorandum calls for monitoring of a partner country's overall system of public financial management. This, it is further noted, requires a coordinated approach on the part of all donors, which should be keyed to existing analytical instruments.<sup>50</sup>

Apart from the donors mentioned above, the advocates of budget support include, among others, CIDA, SIDA, NORAD, DANIDA, ICR, and DEZA. As yet, however, these donors have neither set out any comprehensive strategy nor issued implementation documents on their approaches. In

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48 Netherlands briefing note, in: <http://Remote4.acdicidac.ca/extranet/policy/swapsboard.nsf/SitemapE?Open Agent>.

49 Netherlands Ministry of Foreign Affairs (2001).

50 The memorandum specifically mentions Public Expenditure Reviews (PER), Country Financial Accountability Assessments (CFAA), etc.

Sweden, for instance, the possibility of granting budget support to partner countries is set out in a 1999 set of guidelines on support for partner economic reforms.<sup>51</sup> The guidelines set the stage for support of partner economic reforms, provided that the reforms are geared to economic growth as well as to poverty reduction and sustainable development. Moreover, all such programs must be coordinated with the BWIs and the donor community. The volume of the support provided is geared to progress made on PRSs, and support may be given in the form of import aids, balance-of-payments support, or, increasingly, budget support, although the provision of budget support is made conditional on an analysis of public financial management. Support is normally granted for one year, although it may, in special cases, be extended for several years. The guidelines, which are currently under revision, contain no provisions on the monitoring and evaluation of budget-support projects.

### *Germany*

Program orientation is also an explicit aim of German DC. In addition to its DC guidelines, the BMZ has also prepared a position paper and a set of guidelines on participation in program aid; these formulate the objectives, preconditions, and limits of German participation in joint financing.<sup>52</sup> The BMZ notes in these documents that program-oriented DC in its various forms, from program aid to budget support, contributes better than individual projects to improving national frameworks, overcoming ownership problems, and providing relief for partner countries. The ministry further notes that German DC will for this reason – and wherever it proves reasonable within the framework of its priority strategies – participate in program-based joint financing (PGF).

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51 "Guidelines for support for economic reforms and debt relief," Swedish Ministry of Foreign Affairs (1999).

52 *„Handreichung für die Mitwirkung an gemeinschaftlichen Finanzierungen mit anderen Gebern im Rahmen programmorientierter Entwicklungszusammenarbeit.“* [Guidelines on participation in joint financing together with other donors in the framework of program aid] BMZ (2001a). *„Positionspapier für die Mitwirkung an gemeinschaftlichen Finanzierungen mit anderen Gebern im Rahmen programmorientierter Entwicklungszusammenarbeit.“* [Position paper on participation in joint financing together with other donors in the framework of program aid] BMZ (2001b).

Position paper and guidelines were written in 2001 in response to the new needs that emerged in connection with program orientation. Until now German DC has participated in some 16 PGFs and is preparing a number of other projects. Parts of the guidelines and the position paper as well as the currently valid TC/FC guidelines are in effect outdated, and they no longer adequately reflect the status quo of Germany's participation in PGFs. The TC/FC guidelines are in urgent need of revision to ensure that the formal framework is in line with DC practice. The BMZ has prepared a draft for new TC/FC guidelines and is presently in the process of coordinating the draft within the ministry.

For German participation in PGFs, position paper and guidelines stipulate that German DC should not cover the entire spectrum of joint financing measures. In particular, basket-financing and sector programs could be given consideration for German participation, whereas direct general budget support should be reduced to cofinancing of World Bank PRSCs.<sup>53</sup> In practice, budget support is already being approved without any close link to a PRSC, as in the cases of Mozambique or Ghana, where German DC has joined forces with a group of budget-support donors.

The following conditions are in place for German participation in program aid: First, a joint financing operation must be in accord with the quantitative and qualitative objectives of the German priority strategy paper covering the area for which joint financing is envisioned. Second, it must be ensured that the DC funds provided are used properly. Every possible effort should be undertaken to prevent any misappropriation in the sense of existing FC criteria. It is noteworthy that the accounting procedures for auditing funds provided are expected to meet the customary FC standards even before a financing operation gets underway. There is no explicit mention of strengthened partner structures as an objective of program-oriented DC.

A third precondition is that partner countries are expected to comply with the criteria set out in the FC/TC guidelines. The current version of the guidelines set relatively narrow limits to any German participation in joint

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53 *„Insofern ist die direkte Mitfinanzierung des gesamten Haushalts oder eines sektoralen Haushalts, bei der die Geberbeiträge in das Haushaltsverfahren des Partners einbezogen sind, nur als Ausnahmefall im Rahmen einer Kofinanzierung von Strukturanpassungsdarlehen mit der Weltbank möglich.“* See BMZ (2001b, 10 Ziffer 3).

financing operations. In particular, the guidelines stipulate that partner countries are required to bear the current costs of projects that are granted support. German cofinancing of current costs is possible only in exceptional cases and for a limited period of time. Accordingly, Germany is not able to participate in non-earmarked budget-support operations, which are used to finance both investments and operational costs. Moreover, the TC/FC guidelines stipulate that what is referred to as structural aid be used to finance imports. In the past structural aid has been used to cofinance World Bank structural adjustment measures. This restriction of German contributions to provision of import aids is not practicable in the framework involved in cofinancing PRSCs, which have replaced the structural adjustment credits formerly provided by the World Bank. The reason is that the disbursement of PRSCs, once tied to imports, is now made dependent on whether or not a partner country meets certain policy conditionalities. For structural aid, the BMZ, with the approval of parliament and other ministries, has therefore decided in principle to accept certain deviations from the TC/FC guidelines.

German participation in PRSCs is conditioned on transparent and poverty-oriented public financial management in partner countries. The BMZ has proposed assessing partner public financial management on the basis of the standard World Bank and IMF analyses.<sup>54</sup> According to the position paper, a German contribution can be justified only when a partner's public financial management is of satisfactory quality and the macroeconomic framework is stable. Two further criteria mentioned as conditions for any German cofinancing of PRSCs are unhindered recourse to the law and participation of the population in the political process.

### *Summary*

It can be said by way of summary that the strategy papers on participation in program aid issued by both German DC actors and the bilateral donors known to be outright proponents of a program orientation are relatively general in their formulation and have little to say about specific financing modalities. On the one hand, this may be due, directly or indirectly, to efforts to retain the largest possible measure of flexibility. On the other hand, though, the amount of background experience presently available

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54 It mentions PER and CFAA.

would, at least in some cases, appear to be insufficient to derive any differentiated criteria. The EC's guidelines extend beyond the conceptual positions of other donors, defining rules for reviewing, monitoring, and evaluating budget-support projects. As far as the basic principles, eligibility criteria, and objectives of budget support are concerned, the EC guidelines are largely consonant with the strategies of other donors. One thing they have in common is their orientation to PRSPs and their call for satisfactory development of public financial management systems. One factor that often plays a key role in coming to financing decisions is the will to reform on the part of partner governments and a reform climate that gives reason to expect progress in public financial management.

## 2.6 The political dimension involved in the provision of budget support

Budget support is conditioned on a satisfactory system of public financial management. In the eyes of donors, this is a factor crucial to limiting fiduciary risks. Apart from the risk that support funds may not be used – efficiently – for the purposes intended, there is also a risk that donor funds may be misappropriated. One of the main reasons for this risk is a lack of sound governance. The question in the context is whether and to what extent good governance is generally the subject of EC budget-support reviews. Since good governance is often seen in relation to civil and political human rights and democratic principles, it must furthermore be considered whether these aspects are accorded due heed in the EC's budget support. One possibility here would be to include political conditionalities in the EC's financing proposals.

In the broadest sense of the term, political conditionality may be understood as a development-policy concept under which donors condition the volume and the use of various DC instruments on the political framework conditions given in partner countries. However, there is some controversy as to what political framework conditions should be seen as ideal for sustainable development, a fact which goes to explain the in part substantial differences between concepts of political conditionality. The most frequent criteria and objectives of political conditionality include respect for human rights and democratic principles as well as sound and responsible govern-

ance.<sup>55</sup> Most donor countries condition their development cooperation on compliance with these criteria. One important exception here is the World Bank, whose statutes prohibit it, as a multilateral organization, from taking an active political stance and intervening in the political affairs of its member countries. The one condition it sets for cooperation is good governance, which, while including the rule of law, extends neither to democratic principles nor to political or civil human rights.

ACP-EC relations were also long shaped by political neutrality. Even though the EC's DC has shown clear signs of a practical human rights orientation since the mid-1970s, the Lomé I to II agreements contain no specific articles on human rights or democratization. Only since Lomé IV have human rights clauses been included in the EU's partnership agreements. However, they do not provide for any sanctions for human rights violations. This situation changed with the Cotonou Agreement, which contains provisions designed to substantially strengthen the political dimension. The key provisions are contained in Article 9 and in Articles 96 and 97. Article 9 §2 defines respect for human rights, democratic principles, and the rule of law as "essential elements" of the agreement. Violations are covered by Article 96, which provides for the initiation of a consultation procedure. The aim of these consultations is to thoroughly examine the situation and to coordinate measures to remedy it. Consultations are to last no more than 60 days. If no solution is found, "appropriate measures" may be taken that are in accordance with international law, and proportional to the violation. The article provides for suspension of cooperation as a means of last resort. In cases of special urgency the article provides for the possibility of an accelerated unilateral procedure. Article 9 defines good governance as a "fundamental element" of the agreement, and is thus not covered by Article 96. Article 97, however, likewise provides for the possibility of initiating consultations in serious cases of corruption and authorizes the parties to take appropriate measures.

The greater significance accorded to the political dimension in Articles 96 and 97 of the Cotonou Agreement is linked with a larger measure of political conditionality, a fact which critics see as running counter to the

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55 See Stokke (1995, 21 ff.); the OECD's Development Cooperation Directorate (DAC) also adds "participatory development" as an important criterion for political framework conditions. See Hammel (1997, 22).

underlying idea of partnership.<sup>56</sup> A genuine partnership, they argue, would have to be based on a balanced and open political dialogue that is not regimented by conditionalities. Unconditioned dialogue is also a priority concern of the ACP countries, which reject, above all, any unilateral suspension of cooperation.<sup>57</sup> To accommodate the demands of the ACP countries, Article 8 of the agreement provides for an intensive and balanced political dialogue designed to regularly assess the situation as regards the "essential elements" of the agreement.

Dialogue with partner governments is an important element of cooperation in budget-support operations. Willingness to support and cofinance partner-formulated reform programs presupposes a continuous exchange of information on progress and, if need be, adjustments to a reform agenda. Most budget-support programs provide for policy dialogue as a general condition of financing. What is meant here, however, is not the political dialogue referred to in Article 8 of the Cotonou Agreement. As a rule, political aspects are not discussed: "For the EDF the position is relatively clear: the forum for political issues is the political dialogue defined under Cotonou. This may cover any instrument of cooperation, including budget support. It may well be that budget support should be one of the first instruments to be deployed, but that choice should be made in the context of the political dialogue."<sup>58</sup> The policy dialogue conducted in the framework of budget support focuses on economic questions relevant to reaching the goals of macroeconomic reform and reducing poverty. One important aspect of this dialogue is transparent and accountable administration of the funds provided, which is seen as an element of good governance. Accordingly, the so-called essential elements – human rights, democratic principles, and the rule of law – are not explicitly set as conditions for budget support, whereas the fundamental element of good governance is defined as a condition. A violation of the essential elements may affect budget-support operations only if measures are taken in the framework of a consultation procedure that lead to termination or suspension of support.

Apart from the inclusion of political conditionality as a general condition of a financing agreement, it is also possible to set political conditionalities

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56 See Molt (2002, 65).

57 See Bossuyt et al. (1999, 9).

58 See EC (2004a, 12).

for the choice of the indicators used for disbursement of the variable tranche. In keeping with the guidelines on budget support, these indicators are keyed to the PRSP submitted by a given country. If at all possible, these indicators are expected to be in conformity with the PRSP indicators. The PRSPs of numerous countries set out the goals of strengthening democratic principles and improving general political conditions.<sup>59</sup> Still, EC budget-support projects do not as a rule include indicators that reflect the political perspective of these PRSPs. One innovation that can be used to reconstruct the discussion on political indicators for the variable tranche is the financing proposal on budget support for Ethiopia (PRBS II). On the insistence of several member states, the first version of the financing proposal contained indicators on elections and democratization. The intention was to condition the disbursement of €2 million of the overall volume of €95 million on compliance with these so-called governance indicators. However, during the 377<sup>th</sup> session of the European Development Fund (EDF), which deliberated on the proposal, the EC was unable to present a final goal matrix for these indicators. Agreement had not yet been reached with the Ethiopian government on governance indicators. Several member states then made a case for waiting for the final version of the indicator matrix and postponing the adoption of PRBS II to a later session. The EC rejected this view and came out in favor of an immediate adoption in the EDF Committee. It at the same time assured that it was willing to work in favor of the political criteria, which were something entirely new for Ethiopia, and not to sign the financing accord before agreement had been reached with the Ethiopian government. The outcome was that the financing proposal was adopted unanimously in the same session, even though the UK, Sweden, and the Netherlands took a critical view of the compromise proposal tabled by the EC.<sup>60</sup>

Negotiations with the Ethiopian government continued after the proposal had been adopted by the EDF. At the same time, the EC abruptly found itself in the midst of a fundamental discussion on political indicators for the variable tranche. Critics noted that responding to violations of important elements of the Cotonou Agreement by effecting relatively small reductions in the volume of funds provided was the wrong approach - the

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59 See e.g. the PRSPs submitted by Madagascar, Mali, Ethiopia: RoMad (2003, 63 f.), RoMal (2002, 47), FRoE (2002, 48 ff.).

60 See BMZ (2003, 2).



reason being that the size of the variable tranche is assessed on the basis of a set of indicators covering various priority areas of PRSPs. And since, for the most part, all indicators are weighted equally, the influence of one indicator on the volume of a disbursement is quite limited. It was furthermore noted that since respect for democratic principles, human rights, or the rule of law are of paramount importance, these aspects could not be covered in an individual financing agreement and should instead be regarded as a basic principle of cooperation as per Article 9 of the Cotonou Agreement. This view prevailed in the EC, and the governance indicators were removed from PRBS II. The final financing agreement, which was signed seven months after it had been adopted by the EDF, contains indicators on health, education, private-sector development, infrastructure, food security, and the quality of public financial management. Unlike the *essential elements* not given the form of indicators, nearly all the variable-tranche indicators make reference to the quality of public financial management. This gives the *fundamental element* of the Cotonou Agreement a weight that extends beyond the general policy dialogue provided for. In other words, poor performance on public financial management is sanctioned in the framework of an individual project without casting doubt on the project as a whole. Only in especially serious cases of corruption does Article 97 apply, a situation which makes it possible to suspend all budget support.

### 3 Financial and budgetary scope

#### 3.1 Volumes and trends, 2000–2005

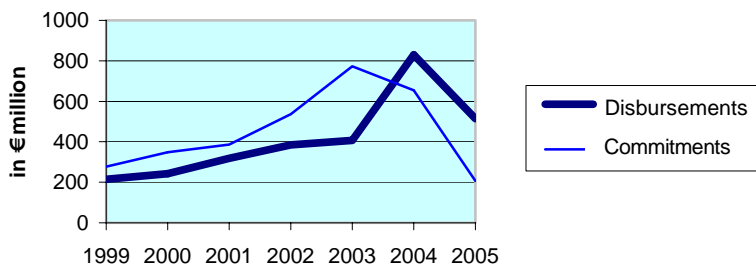
The trend toward program orientation in the EC's DC can be illustrated on the basis of rising figures for budget-support commitments and disbursements (Fig. 4). Between 2000 and 2004 budget-support more than doubled, from €348.23 million in 2000 to €772.8 million in 2003, and a similarly high level was anticipated for 2004. Moreover, the EC has affirmed its determination to increase, or at least to hold constant, the volume of commitments until the end of 2007.<sup>61</sup> A substantial increase in disbursements was anticipated for 2004. While a total of €406.2 million in budget

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61 The 9th EDF is set to expire in 2007. See EC (2004a, 4).

support was disbursed to ACP countries in 2003, a volume of €830 million was expected for 2004 (see Annexes 3 and 5).<sup>62</sup>

**Figure 4: Budget-support approvals and disbursements 1999–2004, forecast for 2005**



Source: Own presentation, based on von EC (2004b, Annex 1)

The sharp rise in approvals in 2003 and disbursements in 2004 is due to the fact that the 9<sup>th</sup> EDF was delayed in coming into effect. The EDF is the Community's most important aid instrument for its cooperation with the ACP countries. Each EDF is set up for a period of roughly five years and is geared to the terms of a partnership agreement. The 9<sup>th</sup> EDF, which was set up when the Cotonou Agreement was signed, is endowed with €13.5 billion for a period of five years.<sup>63</sup> These funds have, however, only been available since the agreement entered into force on April 1, 2003. In an-

62 The data are based on the final agreements with the ACP countries; see EC (2004a), Annex 1. The EDF funds are approved in a two-stage procedure involving the EC and the ACP countries concerned. Once it has received a positive opinion from the EDF Committee, the EC, the agency responsible, comes to a decision on financing. Then, in the framework of a financing agreement, it defines the conditions under which its decision is implemented by the responsible national agency in the country concerned. This may involve slight adjustments in the volumes of the funds approved by the EDF. Furthermore, some financing proposals are signed by the EC only in the calendar year following EDF approval. This explains some discrepancies between the volume of budget support approved per year by the EDF and the data published by the EC (see Annexes 3 and 4, below).

63 See EC (2000c, 2).

ticipation of ratification, a number of comprehensive budget-support programs were planned and prepared for; they were approved as soon as the funds were released, a fact which goes to explain the high level of fund commitments in 2003.<sup>64</sup> The EC envisions expanding budget support over the medium term. Still, the commitments and disbursements forecast for 2005 show a declining trend. The reason for this is that, with a view to launching larger projects, the EC plans to await the results of the mid-term reviews of country programs that were planned for 2004 and that could be used to modify the way resources are allocated.

At present a total of roughly €1.5 billion has been committed as budget support. In 33 ACP countries budget-support programs are either already in operation or planned for the near future. Disbursement of the funds is conditioned on beneficiary compliance with the terms agreed upon. Substantial sums were, for instance, transferred to Benin and Mozambique in 2001. In 2001 Burkina Faso, Zambia, and Tanzania received sizable payments in the framework of budget-support programs. On the other hand, payments were suspended for countries for which the EC noted delays in economic reforms, insufficient government commitment to poverty reduction, or major weakness in public financial management (Senegal, Malawi, Gabon, Central African Republic).<sup>65</sup>

Many recipients of budget support are among the countries that are seen as "good performers," e.g. Tanzania, Mozambique, or Burkina Faso. Even so, the EC does not rule out budget support for countries that have a less positive performance record or are in the process of recovery from a post-conflict situation. The only key eligibility criterion is compliance with the conditions set out in the Cotonou Agreement.<sup>66</sup> Thus far 33 of 77 ACP countries have met the criteria and are receiving budget support.

Apart from general budget support, the EC also provides sector budget support for sector programs. It furthermore participates in basket financing

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64 To ensure that parts of the Cotonou Agreement could be implemented before the agreement took effect, the EC had, in 2002, begun taking steps to commit funds from the 8<sup>th</sup> EDF with a view to the programming projected for 9<sup>th</sup> EDF. This enabled the EC to commit a total of €732,9 million in budget-support funds from the reserves of the 8<sup>th</sup> EDF, which amounted to €1.2 billion. See Europäischer Rechnungshof (2003, 334).

65 See *ibid.* (2003, 10).

66 See EC (2004a, 4).

or provides project-related contributions in support of sector programs. According to provisional data from AIDCO, the present total volume of support provided to sector-specific programs in the education sector is € 117.35 million.<sup>67</sup> In the health sector the EC is currently providing €104.0 million in support for relevant programs. There are, in addition, two basket-financing projects in the preparation phase. In all, 22.5 % of this support is provided in the form of sectoral budget aids, while 38.37 % is provided in the form of basket financing, and 26.64 % consists of contributions to projects.<sup>68</sup>

### 3.2 Budget support and the slow implementation of the EDF

In connection with the debate on greater efficiency and quality of Europe's external aid, many observers have pointed critically to the slow progress made in implementing the EDF, a state of affairs that is reflected in low commitments of funds on the one hand and slow outflows of funds on the other.<sup>69</sup> Since November 2002 at the latest, when Commissioner Nielsen publicly expressed his concern over a total of €11 billion in unutilized EDF resources,<sup>70</sup> more attention has been paid – not least by the EC – to the rhythm in which the EDF is implemented. Various measures have been taken to accelerate the outflow of funds; they include more use of quick-disbursing instruments, i.e. budget support and nonprogrammable aids. This could contribute crucially to ensuring that the 8<sup>th</sup> and 9<sup>th</sup> EDFs do not take so extremely long to implement as their predecessors.

In its annual budget reports the European Court of Auditors has repeatedly pointed to the protracted periods time it has taken to implement the EDF.<sup>71</sup> Table 1 shows the implementation of the 6<sup>th</sup>, 7<sup>th</sup>, and 8<sup>th</sup> EDF on December

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67 See EC (2004b, Annex 2).

68 For one program (volume: € 10.2 million) no information is provided on financing modalities.

69 See Mackie / Frederiksen / Rossini (2004, 5).

70 See Commissioner Nielsen's opening address at the African-European Ministerial Meeting in Ouagadougou on 28 November 2002. In January and April 2003, in a speech held before the Parliamentary Assembly and the Development Committee, Commissioner Nielson criticized the slow implementation of the EDF. See [http://europa.eu.int/comm/commissioners/nielson/speeches/speeches/\\_en.htm](http://europa.eu.int/comm/commissioners/nielson/speeches/speeches/_en.htm) (20 March 2005).

71 See Europäischer Rechnungshof (2000), (2001b).

31, 2000, 2001, and 2002. In the financial year 2000 the three EDFs in the course of implementation entered their fifteenth, tenth, and third years of implementation, respectively. At the end of 2000 39.0 % of the resources of the 8<sup>th</sup> EDF, 98 % of the 7<sup>th</sup> EDF, and 99 % of the 6<sup>th</sup> EDF had been committed. Taken together, € 6.2 billion of the overall fund volume of €31.3 billion were still available for new approvals. This sum was reduced to €4.6 billion in the course of 2001. At the end of 2002 the resources available for new commitments still amounted to € 2.9 billion. In other words, the balance of funds available for new approvals amounted to 9 % of the fund's overall resources, as opposed to figures of 14 % for the end of 2001 and 19 % for the end of 2000.

The slow rhythm of EDF implementation is also visible at the level of disbursements. On December 31, 2000, the volume of committed funds yet to be disbursed was just under €9.0. Most of these funds were committed for pluriannual projects that, depending on the course of program implementation, have either not yet got underway or are being transacted in tranches.<sup>72</sup> Even though such relatively high levels of committed but undisbursed funds are, accordingly, not unusual, disbursements have remained behind the targets. If we compare e.g. the implementation of the budget in 2001 with the cash resource requirements estimated by the EC at the end of 2002, we find that disbursements accounted for only 80 % of the volume estimated. The year 2002 saw a further slowdown in the outflow of funds, a fact due in part to persistent unrest in a number of ACP countries. At the end of 2002 the volume of funds that had been appropriated but not disbursed amounted to €8.4 billion – as opposed to disbursements amounting to €1.9 billion.

The EC distinguishes between normal, as yet undisbursed funds that are committed to pluriannual projects or reflect new commitments that have not yet been disbursed and problematic funds that have been committed but not disbursed. Commitments are termed problematic if no funds have been disbursed for a project within two years time or a period of five years has elapsed since the funds were appropriated. 14.4 % of the €8.4 billion in funds not disbursed as of December 31, 2002, was attributed to prob-

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72 According to EC information, the levels of committed funds that have not been disbursed are in line with the average for EU member states or even lower in proportional terms. See KOM (2003a, 6).

lematic commitments. These funds, often referred to as "dormant commitments," are very difficult to utilize for a project other than the one for which they were originally approved.<sup>73</sup>

In other words, at the close of 2002 a total of €11.3 billion from the EDFs had not been utilized; roughly three quarters of this sum was accounted for by appropriated funds that had not yet been disbursed, and one quarter was available for new commitments. The funds that were still available were transferred to the 9<sup>th</sup> EDF when the Cotonou Agreement entered into force on April 1, 2003. Since then it has not been possible to commit any further funds from the 6<sup>th</sup>, 7<sup>th</sup>, and 8<sup>th</sup> EDFs.<sup>74</sup> In the 2003 financial year the EC undertook new commitments amounting to €3.7 million and disbursed a total of €2.2 million.<sup>75</sup> At the end of 2003 the balance of uncommitted funds from the 9<sup>th</sup> EDF (including the residual funds from the 6<sup>th</sup>, 7<sup>th</sup>, and 8<sup>th</sup> EDFs) was €11.9 billion. On the other hand, €9.7 billion had already been approved but not yet disbursed.<sup>76</sup>

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73 See KOM (2003a), p. 6. Unlike the EC's definition, the European Court of Auditors refers to commitments as "dormant" if no disbursements have been made during the previous 18 months. See Europäischer Rechnungshof (2003, 332).

74 Until the Cotonou Agreement was ratified, the 6th, 7th, and 8th EDFs were implemented in parallel. While it is true that in principle these funds also have a five-year term, there are no time limits on their use until the EC determines that each fund has in effect been implemented and transfers the residual resources to a later fund. See Europäischer Rechnungshof (2000, 208).

75 See KOM (2004, 10).

76 See Europäischer Rechnungshof (2004, 439).

<b>Table 1: Implementation of the 6<sup>th</sup>, 7<sup>th</sup> und 8<sup>th</sup> EDFs, 2000–2003 (in €million)</b>		
	<b>Volume committed but not yet disbursed</b>	<b>Appropriated funds</b>
<b>As of the end of 2000</b>		
6 <sup>th</sup> EDF	360.0	333.0
7 <sup>th</sup> EDF	2255.1	854.0
8 <sup>th</sup> EDF	6367.8	4960.7
Total volume	8982.9	6147.3
Implementation rate	27.40 %	18.80 %
<b>As of the end of 2001</b>		
6 <sup>th</sup> EDF	295.3	347.2
7 <sup>th</sup> EDF	1896.4	700.6
8 <sup>th</sup> EDF	6277.5	3596.7
Total volume	8469.2	4644.5
Implementation rate	25.80 %	14.20 %
<b>As of the end of 2002</b>		
6 <sup>th</sup> EDF	249.6	344.4
7 <sup>th</sup> EDF	1696.3	583.0
8 <sup>th</sup> EDF	6438.9	1991.8
Total volume	8384.8	2919.2
Implementation rate	25.50 %	8.90 %
Source: Own presentation, based on data from the European Court of Auditors		

The slow implementation of the EDFs is due in part to political reasons, including reduction or even suspension of aid because of unrest in partner countries (Togo, Sudan, Democratic Republic of Congo, Burundi, Madagascar, Kenya, etc.). On the other hand, there are also structural reasons, e.g. lack of capacity of partner administrations to absorb funds, a state of affairs that continues, despite the assistance provided through the EDF as well as by other donors. Two other reasons must be sought in the Commission's administration of aid, which – despite definition of priority areas – is

marked by high levels of dispersion, as well as by cumbersome implementation procedures (contracts, payments) and inadequate project preparation.<sup>77</sup>

In the financial year 2000, in connection with its reform of external assistance, the EC took the following measures to accelerate the outflow of funds and the effectiveness of the EDFs:

- A gradual transition to budget support.
- Improvement of the quality of project preparation based on a new concepts of resource allocation (sliding programming) which makes it possible to modify the way resources are allocated, e.g. on the basis of performance aspects.
- Mid-term and final reviews of country-specific cooperation strategies.
- Use of deconcentration to raise the efficiency of administrative processes.
- Use of public contracts to simplify award procedures.
- Institutional capacity-building in the ACP countries.

Except for the quick-disbursing instruments, however, the effects the measures have on the EDF are likely to materialize only over the medium term.<sup>78</sup> On the other hand, the EC, making more intensive use of the instrument of macroeconomic budget support, has been able to effect tangible increases in both commitments and disbursements. This instrument accounted for 23 % of the decisions made in 2002, as compared with figures of 14 % in 2001 and 12 % in 2000.<sup>79</sup> At the end of 2002 the dis-

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77 See Europäischer Rechnungshof (2001b, 425).

78 See Europäischer Rechnungshof (2003, 336).

79 In its 2003 report on the EDF the European Court of Auditors calls on the EC to supply some missing data on the state of implementation of direct budget support. This budget support could not be assessed on the basis of the EDF accounts because the data stemmed from different financing instruments. This also explains the disparities between the data provided by the EC and the report prepared by Court of Auditors, which e.g. estimates the volume of the decisions on budget support taken in 2002 at €404.3 million, whereas the EC indicates a figure of €535.6 million (see. Annex 4). The Court of Auditors recommends that measures be taken to ensure that in the future information on financing modalities contain precise data on the volume of the support provided. See Europäischer Rechnungshof (2003, 335 and 339).



bursements made in the form of budget support accounted for 20 % of overall disbursements, as compared with a figure of 15 % in 2001. As the EC affirms, the 2003 financial year experienced the best EDF results for commitments and disbursements since the start of the cooperation agreements with the ACP countries. One important factor involved here was budget support, which accounted for a volume of approvals amounting to €807.6 million.<sup>80</sup>

There is no doubt that the gradual transition to budget support has had positive effects on the implementation rhythm of the EDFs. Budget support is used explicitly as a quick-disbursing instrument and, compared with the system of project financing used until now, it also contributes to speeding up the outflow of funds. Even so, budget support should not be misunderstood as a mere vehicle for accelerating outflows. Budget support is instead an important component of the EC's new development-policy strategy, one that reflects efforts to boost the effectiveness of DC.

The EC's Country Strategy Papers (CSPs) clearly indicate whether budget support is tied into a comprehensive country-level program or provided ad hoc to countries for which commitments and disbursements have not met expectations. The CSPs, which the Council has ordered to be prepared for all ACP countries, set out a working program for three to five years. They define fields of cooperation, formulate measures required to meet the objectives set out, and provide some initial indications on resource allocation. The CSPs contain on average 21.4 % of the programmable funds earmarked for budget support. Other important cooperation sectors include transportation (30.7 %), health and education (10.7 %), and rural development (8 %).<sup>81</sup>

Comparison of the budget-support funds programmed and appropriated by the end of 2003 shows that the relevant Country Strategy Papers provided for budget aids in nearly all countries for which the EDF had approved budget support. The only exception is the Cape Verde LSP, which con-

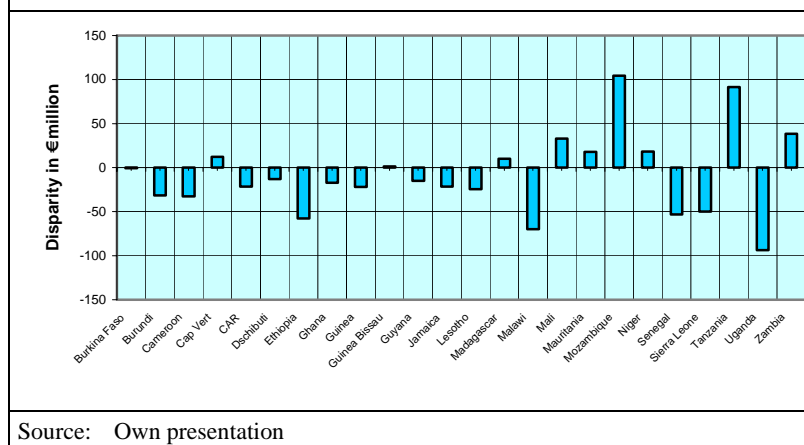
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80 See Europäischer Rechnungshof (2004, 439).

81 In essence, the financial resources of the 9th EDF are earmarked for programmable A-envelope aids (macroeconomic budget support, sector programs, and development-assistance projects) and nonprogrammable B-envelope aids (emergency aid, aid for debt reduction and mitigation of export slumps). The figures cited refer to 61 of 76 CSPs that were evaluated in March 2002. See EC (2002).

tains no reference to the budget support that was later approved. However, there are some major disparities as regards the funding volumes programmed and approved for budget support (Fig. 5). Since most CSPs are valid until 2007, however, it is not possible to make any final assessments on the congruence between planning and implementation. Furthermore, under sliding programming it is possible to modify CSPs. Based on the mid-term reviews conducted in 2004 for all ACP countries, it is possible to modify allocations both within a country program and between ACP countries.<sup>82</sup> Not only needs criteria but also criteria designed to measure partner-government performance are used for purposes of review.<sup>83</sup> These performance criteria refer on the one hand to the recipient country's implementation of national benchmark programs and on the other hand to progress made in priority sectors as well as on macroeconomic stabilization. In this system appropriations in excess of an originally programmed

**Figure 5: Disparity between EC-approved budget support and allocations for the NIP**



<sup>82</sup> See EC (2003a, 3).

<sup>83</sup> See DG DEV (2000), p. 9. Resource allocation under sliding programming is referred to in the secondary literature as a "performance-based allocation system" or as "performance-based partnership." See e.g. Santiso (2002, 120).

sum tend more to indicate good recipient performance than problems involved in program transaction. At the end of 2003 the sums earmarked for budget support in Ghana, Mozambique, and Zambia had been approved in full. To avoid any interruption in the budget support to these countries, which are able to absorb the funds, additional budget aids were included in planning, within the framework of the country-specific mid-term reviews.<sup>84</sup>

As a means of ensuring that a more rapid implementation of the EDFs based on increasing budget support does not adversely affect the quality of the EU's external aid, the EC is required to determine that the eligibility criteria for support are met in the partner countries and to review them on a continuous basis in the course of sliding programming. All initiatives in favor of more budget support are predicated on satisfactory quality of public financial management and control procedures in the ACP countries concerned. The EC is responsible for strictly monitoring the fulfillment of all target criteria. The reason why this is so important is that the procedures involved in the separate EDF administration for budget support have been suspended in favor of national procedures in the ACP countries. The following section will look into the measures the EC takes to review national procedures and the way in which the EC concretely formulates budget support.

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84 For Mozambique the MTR recommends an increase in the A-envelope (from which budget support is financed) of €205.25 million. Increases of €80 and €55.2 million are recommended for Zambia and Tanzania, respectively.

#### **4 Program conception and implementation: central characteristics of the EC's budget-support programs**

The budget-support guidelines adopted in March 2002 set out the central elements of EC budget-support operations. The guidelines sum up the budget-support reforms that have been embarked upon successively since 2000; they have since been adopted by the EC and the Council in several reference documents. The aim of the following sections is to work out some of the central characteristics of the budget-support concept and to examine whether and to what extent they have been used in preparing the financing proposals for budget support.

Between January 2000 and December 2003 the EDF Committee adopted 50 financing proposals for macroeconomic budget support. The proposed programs are mainly concerned with budget aid designed to support partner countries in conducting macroeconomic reforms (47). Due to short-term problems in the beneficiary countries concerned, three financing proposals were prepared and disbursed as emergency aid. The present study evaluates all financing proposals that were adopted in the period in question and exceed a volume of €15 million.<sup>85</sup> These are 30 programs for 18 countries (Table 2), for which a total of €1.7 billion was approved. The program with the largest approved volume – €168 million – was for Mozambique (PRBS II).

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85 The PARPAS V (Niger) and PABS 4 (Uganda) programs could not be evaluated for lack of documentation.

<b>Table 2: Programs examined in connection with the present study</b>			
<b>EDF meeting</b>	<b>Recipient country</b>	<b>Program titel</b>	<b>Volume appropriated (in €million)</b>
358	Benin	Programme d'appui aux réformes économiques PARE 2001	18.8
379		Appui budgétaire conjoint pour la réduction de la pauvreté (2003 – 2005)	55.0
358	Burkina Faso	Appui budgétaire pour la réduction de la pauvreté ABRP	23.5
370		Appui budgétaire pour la réduction de la pauvreté	125.0
373	Burundi	ADARE 2003 Programme Aligement de la Dette et Appui aux Reformes Economiques	22.6
358	Cameroon	Poverty Reduction Budgetary Support	19.51
358	CAR	Structural Adjustment Support Programme 2001/2001	22.0
358	Chad	PRBS 01-02	37.1
378		Programme d'appui budgétaire pour la réduction de la pauvreté et la croissance	50.0
364	Ethiopia	SAS II BIS Structural Adjustment Support	25.7
368		Poverty Reduction Budget Support PRBS I	44.0
377		Poverty Reduction Budgetary Support PRBS II	95.0
365	Ghana	Poverty Reduction Budgetary Support PRBS 2001	37.8
354	Guinea Bissau	Programa de Apoio às Reformas Economicas (PARE I)	17.2
360	Jamaica	Support to Economic Reform Programme II (SERP II)	21.7
373		Support to Economic Reform Programme III (SERP III)	30.0
356	Kenya	Poverty Reduction Budgetary Support PRBS 1	35.0
359	Lesotho	Poverty Reduction Budgetary Support Programme (PRBSP) 2001/2002	18.5

<b>Continued Table 2</b>			
<b>EDF-meeting</b>	<b>Recipient country</b>	<b>Program titel</b>	<b>Volume appropriated (in €million)</b>
365	Mali	Programme d'appui budgétaire au cadre stratégique de lutte contre la pauvreté	25.8
379		Programme pluriannuel d'appui budgétaire au cadre stratégique de lutte contre la pauvreté	132.9
359	Mauritania	Programme d'appui budgétaire à la réduction de la pauvreté PAS IV	18.3
358	Mozambique	Poverty Reduction Budget Support I (PRBS I)	65.7
372		Poverty Reduction Budget Support II (PRBS II) 2002–2005	168.0
376	Niger	Programme pluriannuel d'appui à la réduction de la Pauvreté (PPARP) 2003–2005	90.0
358	Rwanda	Structural Adjustment Support Programme SAP II	59.6
378		Programme pluriannuel d'appui à la réduction de la Pauvreté 2003–2005 (PPARP)	50.0
360	Tanzania	Poverty Reduction Budget Support for FY 01/02 (PRBS 01)	76.1
376		Poverty Reduction Budget Support Programme 2003–2006 (PRBS 02)	114.0
353	Zambia	Structural Adjustment and SYSMIN Support Programme (SAF V / SYSMIN)	109.6
379		Poverty Reduction Budget Support Programme 2004–2006 (PRBS 01)	117.0
Quelle: Own presentation			

To date, more than one budget-support program based on the new budget-support concept has been adopted only for a limited number of ACP countries. However, it will be a number of years before a final, guideline-oriented evaluation of the programs can be conducted. The same applies for the anticipated effects – for instance, as regards increased partner ownership, strengthening of public financial management systems, etc. Some first experiences with program implementation are included in the study in the form of two country examples (Ethiopia, Mozambique).

## 4.1 Financing modalities and design of EC budget-support programs

### 4.1.1 Direct, untargeted budget support: genesis, justification, and risks

Viewed in historical terms, the budget support provided by the EC is linked with the concept of "counterpart funds." Counterpart funds are revenues that accrue, in the course of financial cooperation, in the currency of a recipient country, e.g. from sales to nationals of imports or import licenses. The 7<sup>th</sup> EDF provided support for structural adjustment in partner countries in the form of general import programs or sectoral import programs. The funds for these programs, which were disbursed in foreign exchange, gave rise to counterpart funds that were used to finance budgetary expenditures. The uses to which these foreign-exchange funds were put were required to be documented on the basis of import papers. However, importers paid their invoices in domestic currency, and this was handled by setting up counterpart funds in domestic currency.<sup>86</sup> The provision of funds that are transferred to a foreign-exchange account before they flow into the national budget is referred to as indirect budget support (Fig. 6).

The revision of Lomé IV undertaken in Mauritius created the possibility of providing direct budget support to countries with fully convertible and transferable currencies.<sup>87</sup> With this type of aid, recipient countries are no longer required to present import documents for the foreign exchange they receive. The funds are directly integrated into their national budgets and then channeled on.

The transition from indirect to direct budget support was effected in conformity with the recommendations of IMF and World Bank, and the consequence was that a major share of the structural adjustment aids provided from the 8<sup>th</sup> EDF were allocated in the form of direct budget support. The

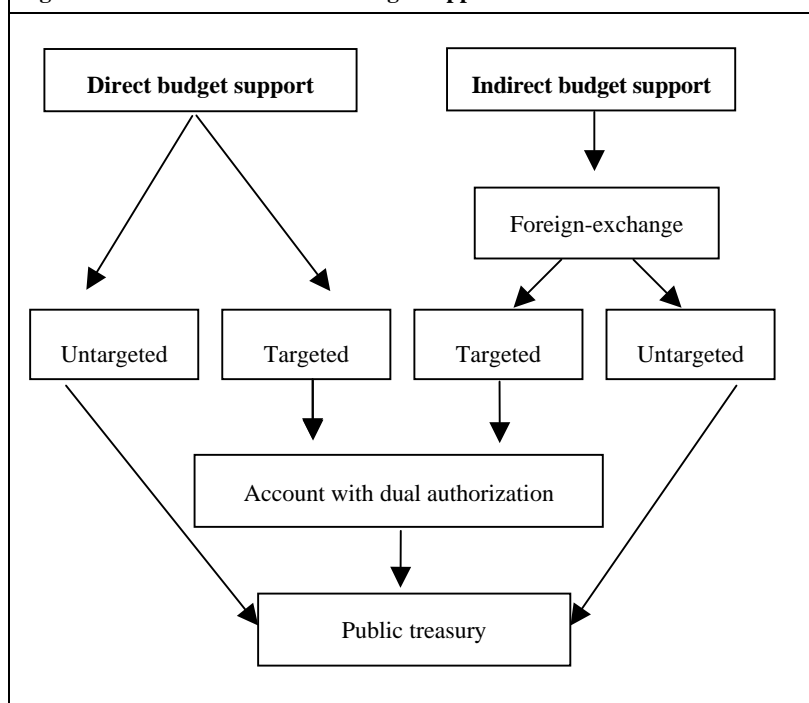
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86 The funds provided from the EDF are first transferred in Euros to an account set up for the purpose in a partner country, usually with the central bank. Then the equivalent value of these funds is transferred in domestic currency to an account opened with the same bank.

87 See Article 224 of the revised version of Lomé IV.

intention here was to use the additional budget resources in particular to support prioritized social sectors such as health and education. This seemed called for because structural adjustment programs as a rule require the countries concerned to restructure their public expenditures in ways that adversely affect the social services on which poorer population groups rely.<sup>88</sup>

**Figure 6: Direct and indirect budget support**



a To be signed at the same time by the EC representative and the authorized national representative

Source: Own presentation

88 See Europäischer Rechnungshof (2001a, 5).



To ensure that these budget resources are used to the benefit of the social sectors, the EC stipulated that expenditures be purpose-tied. 35 % of the structural adjustment aids provided between 1991 and 1998 were targeted to the health sector, 30 % to the education sector. Other sectors accorded a certain priority included transportation (road maintenance) (8 %), administrative decentralization (3 %), and rural development (3 %). Current expenditures (61 %) were accorded priority over spending for investment (29 %) or debt reduction (10 %).<sup>89</sup>

In many partner countries EC budget support has been used to cover all current costs for the health and education sectors (without wages and salaries), and this has generally led to satisfactory levels of budget implementation. Without support the levels of budget implementation would have been very low, as it was e.g. in Malawi, where the EC covered 98 % of the health ministry's administrative expenditures.<sup>90</sup>

Still, there are reasons to question the efficiency of targeting. For one thing, in selecting funds to be targeted the focus has not always been on the intended impacts in the social sectors. In some cases budget support served primarily to speed up the provision of resources for the budgets concerned, while in other cases the main concern was to ensure that the subsequent administrative and accounting efforts required to document the use to which the funds were put would not prove too difficult. Control of the use of these funds was in some cases restricted to a requirement to later provide a formal documentation of expenditures, but one that did not trace a direct link between these expenditures and the delivery of social services to poorer population groups.<sup>91</sup> For another, targeting was frequently bound up with cumbersome internal EC administrative procedures, a fact which proved to have more or less marked counterproductive effects on budget implementation. There were, for instance, cases in which expenditures were delayed because the required control modalities were too protracted or because of misunderstandings regarding the logic of budget support.

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89 These averaged values refer to 96 % of the sums financed from the 7th EDF between 1991 and 1997 as well as for 23 programs for which resources were provided in 1998 from the 8th EDF. See KOM (2000b, 10).

90 See Groupement 2AC Associés Audit et Conseil - Transtec - Deloitte & Touche Spain (2000, 22).

91 See Europäischer Rechnungshof (2001a, 257).

Despite these technical deficits, the concept of targeting came in for criticism for not focusing on the overall situation involved in public financial management. However, because all public budget funds are fungible, the only way to audit whether the support provided has been used properly is in the framework of the overall budget. Furthermore, the choice and financing of individual eligible expenditures has no sustainable effects on the quality of public financial management in the countries concerned. For the structural adjustment loans it has provided since 1996, the World Bank has focused more on monitoring general budget implementation than on controlling the exact uses to which the funds provided have been put. Although the EC has been providing comprehensive budget support since the 7<sup>th</sup> EDF, it was only in 1998 that it started to conduct holistic evaluations of the budget systems of the ACP countries. In subsequent years, however, audits continued to be limited to monitoring expenditures equivalent to the amount of Community support provided.

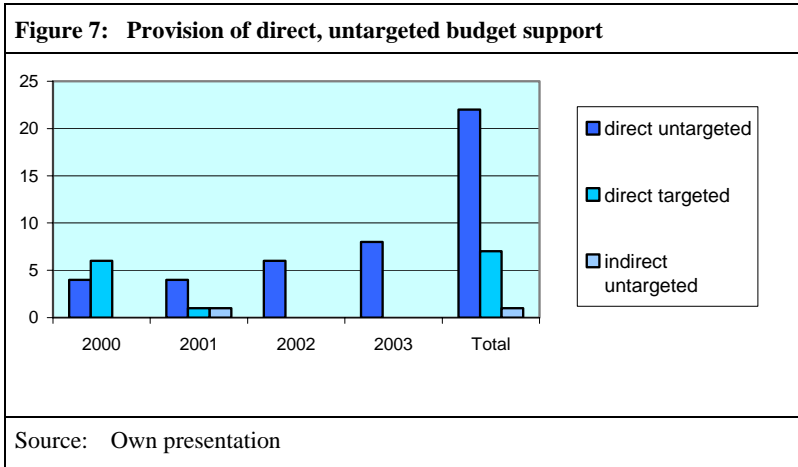
Starting in 2000, the EC gradually abandoned its practice of targeting expenditures in favor of a less detailed allocation of resources for countries with satisfactory public financial management systems.<sup>92</sup> Since then the funds have been transferred to a recipient-country account that does not need to be countersigned by the EC.<sup>93</sup> Targeting continues only for countries that have substantial difficulties in implementing their budget and administering public finances. 23 of the budget-support programs looked into here provide for a untargeted provision of funds. 29 programs directly channel the support provided to the recipient country's budget (Fig. 7).

The transition to direct and untargeted budget support requires partner governments to participate in a dialogue on important strategic issues of poverty reduction. Since the funds provided are channeled into the overall budget, the donor has a legitimate claim to monitor, and if need be to influence, the recipient's poverty-oriented budget planning and implementation. Many financing proposals point to the importance of a policy dialogue covering both government expenditure priorities and the measures

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92 See KOM (2000b, 22).

93 Targeted funds are transferred to a dual-authorization account set up by the recipient country, usually with the central bank. Account transactions require dual authorization by the EC representative and the authorized national representative.



and procedures required for implementation. Over half of these programs explicitly stipulate a satisfactory policy dialogue with the recipient government as a condition for program implementation.

First experiences clearly indicate that untargeted budget support tends to promote policy dialogue between the EC and recipient governments. Ethiopia is one example of a gradual upgrading of policy dialogue in connection with the provision of budget support. Here, the first two assessment missions of a group of donors (see Box 1), which included the EC, found a situation marked by slow-moving negotiations and a lack of willingness on the part of the government to engage in dialogue. It was during the last mission, in September 2004, that this reticence was overcome, and there are now clear-cut signs for an improvement of the policy dialogue. The EC and the bilateral donors in particular see budget support as an instrument well suited to entering into a policy dialogue with the Ethiopian government on a number of critical questions, including e.g. budget-related issues. Until then this avenue had been open only to the World Bank and the IMF.

While budget support is a relatively new instrument in Ethiopia, other ACP countries have been provided budget support for roughly four years now, and the process is accompanied by a comprehensive and intensive dialogue between donors and government. In Mozambique the government and its donors hold regular consultations on the support provided and

progress made in implementing the country's PRSPs. The discussion culture that has developed between donors and government is an open and productive one that is marked in particular by a willingness to engage in a targeted debate on budget matters. In Uganda dialogue with the government has moved on to concentrate on cross-cutting issues concerning poverty reduction and PRSP implementation, instead of focusing exclusively on the efficiency of individual donor interventions.<sup>94</sup>

In the context of untargeted budget support, effective use of the EDF funds provided hinges on the quality of public financial management and control procedures in partner countries. The procedures used for budget support are the same as those applied for the public expenditures of partner countries, that is, they are subject to the same internal controls and thus the same risks as expenditures covered by national financial resources. Since 2000 numerous ACP countries have taken steps to initiate comprehensive reform programs aimed at strengthening their public financial management. This is of course a complex and long-term process, and in its initial phase it is not possible to rule out certain shortcomings in the proper and effective use of the budget support provided. It is the EC's responsibility to gradually reduce these risks by encouraging partner countries to embark on a concrete course of reform implementation.<sup>95</sup>

Efficient support of comprehensive budgetary reforms presupposes close cooperation between the EC, together with other donors of budget support, and national oversight authorities. Many older financing proposals failed to precisely define and coordinate the roles of the individual actors involved. Nor is it sufficiently clear what instruments the EC plans to use to assess public budget management and progress on reforms in partner countries. In connection with the transition to untargeted budget support, substantial efforts have been made to more precisely define measures in the field of spending controls and to intensify coordination with other donors, as more recent financing proposals clearly indicate (see Chapter 4.4).

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94 See ODI / OPM (2002, 28).

95 See Europäischer Rechnungshof (2001a, 16).

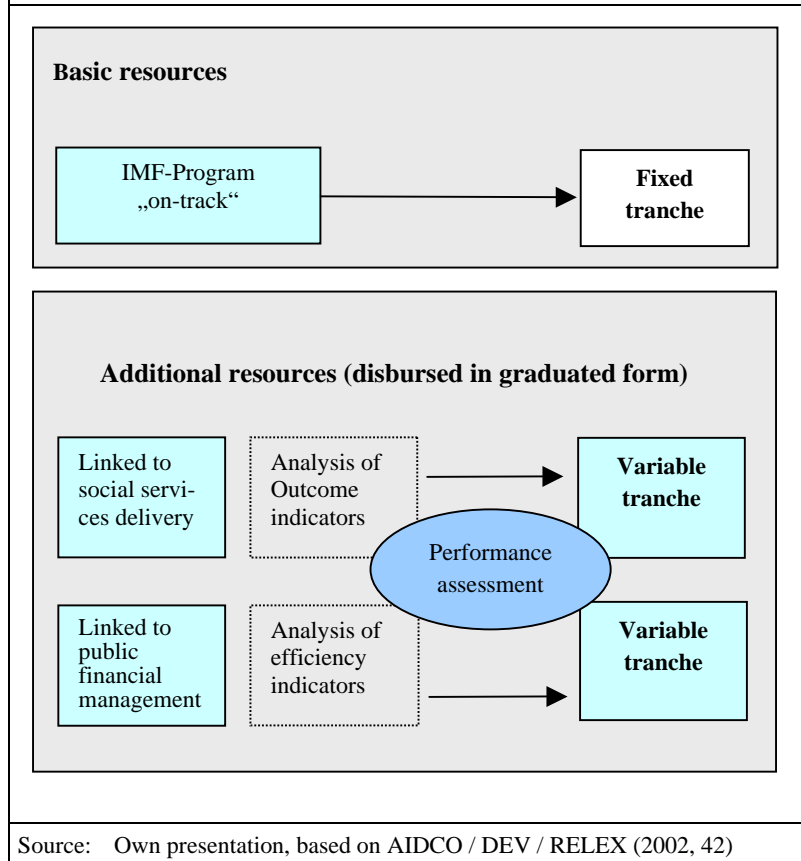
## 4.1.2 Time horizon and program structure

The EC defines a pluriannual timeframe for its budget-support programs. As far as possible, these should be three-year programs that are adapted to the timeframe of national PRSs and BWI programs (PRSC and PRGF). Steps should be taken to ensure that with the PRSs strategic priorities be defined for all important policy fields and that funds available over the medium term be allocated in keeping with these priorities requires partner countries to engage in realistic and forward-looking budget planning. Under pluriannual donor programs budget support tends to be more predictable, and such programs help partners to assess their future financial scopes at an early point of time and to take timely steps to counteract any undesirable financial developments.

The EC shows clear-cut signs of a tendency toward longer-term programs. While the budget supports approved in 2001 had a one-year term, those approved in 2003 are to run for three years. The support is to be disbursed in several tranches, with a distinction being made between fixed and variable tranches. The rule is to be disbursement of one fixed and one variable tranche per year (see Figure 8).

European budget support is based on the principle of fixed tranches. These are designed to improve the economic and financial balance in partner countries and are used in coordination with the IMF; as a rule the disbursement of the fixed tranche is conditioned on a partner's implementation of a macroeconomic program coordinated with the IMF. There are only two options: Either the full sum originally earmarked is disbursed or disbursement is suspended. There is no provision for reducing the fixed tranche for reasons, say, of problems encountered in the course of implementing the macroeconomic strategy agreed on.

**Figure 8: The structure of EU budget-support programs**



The volume of the variable tranche is keyed to the contribution of budget support to improving the situation in priority sectors. These include health and education and public financial management. Disbursement of the variable tranche is linked to outcome indicators coordinated with the partner government. If the targets agreed upon are not fully reached, the tranche is reduced accordingly<sup>96</sup> (see Chapter 4.3). Although the variable

<sup>96</sup> The proportion of the variable tranche that is, in the end, not disbursed is paid into the national indicative programs (NIPs) of ACP countries.

tranche is not directly conditioned on the implementation of a macroeconomic program, the tranche is not disbursed if the IMF assesses macroeconomic progress as insufficient and suspends its own support.

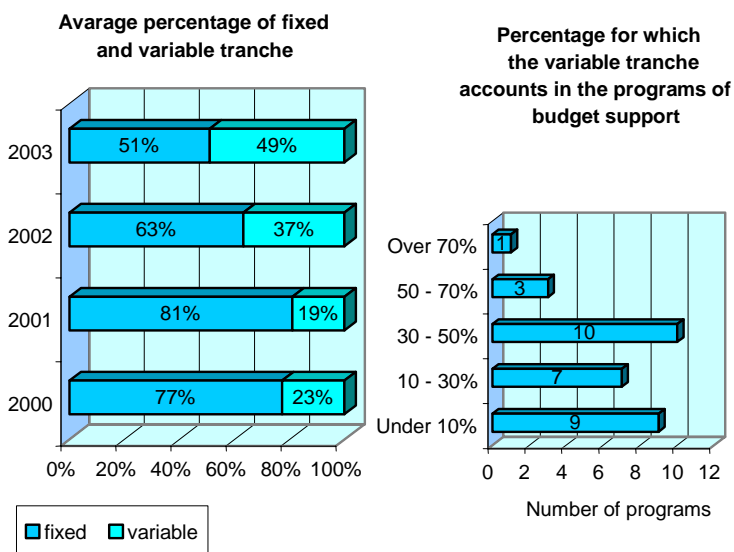
Most of the budget-support programs adopted between 2000 and 2003 distinguish between a fixed and a variable tranche. Over 70 % of financing proposals provide for disbursement in one or more variable tranches. On the whole, we can make out a clear-cut trend toward the use of variable tranches, and in 2003, for the first time, all financing proposals adopted by the EDF make use of the variable tranche as a vehicle for disbursing budget support.

Although the guidelines contain no rules on splitting up the overall volume of budget support into fixed and variable tranches, the practice that has developed is to assign a weight of 50 % to each tranche type (see Fig. 9). For the first year, many programs, e.g. in Benin, Burkina Faso, Tanzania, and Mozambique, provide a relatively small sum as a variable tranche and then increase the sum in subsequent years at the expense of the fixed tranche. Only a small number of financing proposals provide any justification of the way in which funds are assigned to the two tranche types. One exception is the financing proposal for Tanzania. Of all the programs under consideration, the budget support provided to Zambia is striking for the fact that over 90 % of the funds concerned are disbursed in the form of a variable tranche.<sup>97</sup> The reason for this is doubts on the part of the EC as to the Zambian government's willingness to effectively implement the reforms agreed upon in the social sectors. The high sums conditioned on conformity with the performance indicators is seen as a means to induce the government to commit itself to improving services for poorer population groups.

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97 The total program volume is €117 million, with 7 million earmarked for TC, 10 million disbursed in the form of a fixed tranche, 100 million paid out as a variable tranche.

**Figure 9: Fixed and variable tranches as a percentage of total volume of support**



Source: Own presentation

Beside the fixed and variable tranches, an average of 5-10 % of the overall volume of budget-support programs is earmarked for technical cooperation. These TC funds are used chiefly to support the following activities:<sup>98</sup>

- monitoring of sector policies and PRSPs;
- monitoring of budget implementation;
- capacity-building in the fields of budgetary planning and external and internal oversight (e.g. efforts to strengthen auditing authorities and parliamentary control);
- improvement of public financial management;
- preparation of specific studies.

<sup>98</sup> See EC (2004a, 15).



No uniform program structure is stipulated for the sector budget support provided by the EC. The support is implemented in the framework of a SWAP or a sector policy, and the level or number of tranches is derived from the annual or medium-term sectoral financial planning of partner countries. Here performance-linked variable tranches are given precedence over fixed tranches.

## 4.2 Embedding the EC's budget support in the PRSP process

One of the aims of the EC's macroeconomic budget support is to strengthen partner PRSPs by providing contributions to their national budgets. All of the financing proposals for countries that have already adopted a PRSP when support was approved address the PRSPs and define their implementation as a central program objective.

In the framework of the PRSP process partner governments formulate strategic priorities that are then required to be translated into sector policies and programs and implemented through the public budget. The task of the donors is to provide partners flanking assistance in budget formulation and implementation with a view to translating the goal of poverty reduction into realistic and effective programs and to coordinate their DC contributions with these programs. Whether or not EC budget-support programs are aligned with national PRSPs hinges – apart from substantive coherence with their PRSPs – on the manner in which they are embedded in the national PRSP and budget process.

To ensure that budget-support programs are consistent with the substance of PRSPs, the criteria on which disbursement is conditioned need to be based on targets formulated by national decision-makers in the framework of their poverty-reduction strategies. In the past it was rare for policy matrices to be worked out and imposed from the outside. This is why one of the EC's important concerns is "to draw its variable tranche indicators and targets from the PRSPs and associated Annual Reviews"<sup>99</sup> (see Chapter 4.3.3). One exception here must be seen in the conditions set for public financial management. Most PRSPs deal only marginally with public

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99 EC (2004b, 6).

financial management and thus do not provide a sufficient basis to monitor weaknesses and progress in this field so central to budget support.

Embedding budget support in the PRSP and budget process is intended to provide relief for partner capacities and to reduce transaction costs. Excessive strains on capacities in partner countries can best be avoided when DC contributions are monitored on the basis of national systems, i.e. when they are used to track the implementation of PRSs. As a rule annual progress reviews (APRs) are used to document and review PRS implementation. Of the 42 countries that have prepared a final PRSP, 23 have already conducted one or more APRs, and the average time between these APRs is roughly 14 months.<sup>100</sup> The EC has come out in favor of making use of the results of these PRSP monitorings. "Joint Budget Support processes should be constructed to base their review of implementation on the country's domestic review of progress, which would normally be its Annual Review of PRSP."<sup>101</sup> However, most countries are still in the process of developing their PRSP monitoring systems. Both recipients and donors see themselves faced with difficulties in collecting and processing viable sectoral data as well as in assessing public-sector contributions to reaching the growth targets they have defined. Furthermore, thus far only a limited number of countries have succeeded in involving their parliaments and civil society in the discussion on their performance and the success they have met with in implementing their PRSs and in establishing the APRs as a national control instrument for monitoring government performance (accountability).<sup>102</sup> As far as the monitoring of EC budget-support programs is concerned, most financing proposals indicate their intention to make use of the annual progress reviews. Moreover, a good part of TC-related budget-support contributions are earmarked for the further development of PRSP monitoring systems as well as for support for APRs.

Making use of national APRs not only eases the strain on partner capacities, it also has far-reaching implications for the budget process. If the results of the progress reviews are available in time, they can be used to make adjustments to counter deviations from goals and unforeseen developments and to incorporate these adjustments into the budget-planning

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100 See IDA (2004, 10 f.).

101 EC (2004b, 7).

102 See ODI (2004, 15 f.).

process for the next financial year. Donors that condition aid disbursement on an APR are in this case able to inform the government concerned, even before it prepares its budget, of the exact volume they will be providing for the coming financial year and to disburse the funds at the beginning of the financial year. This serves to increase aid predictability and enable partners to come up with a more realistic appraisal of the financial resources actually available to them in the financial year in question. Mozambique is one example of a country where donor contributions and EC budget support have been successfully embedded in the national PRSP and budget calendar (Box 2).

However, despite appreciable progress, many partner countries have remained below expectations in their efforts both to translate their PRSPs into national budgets and in embedding donor contributions in their PRSP and budget calendars. While most PRSPs do concentrate on the poverty-oriented composition of their public expenditures, focusing in particular on the social sectors, they still have little practical usefulness for the budget process because the strategic priorities set tend to be very global and costing practices are as a rule underdeveloped.<sup>103</sup> APRs are often conducted too late to permit the results to be used for planning for the next budget. In addition, only a limited number of countries have the medium-term financial planning capacities that are of central importance in harnessing and using long-term cross-sectoral strategies like the PRSPs.<sup>104</sup> The difficulties involved in deriving detailed budget planning from the PRSPs are not the least reason for the fact that only roughly half of the financing proposals under consideration here provide figures on the percentage that support accounts for in a given budget. The debate over the structural adjustment support previously provided to boost balances of payments focused on the size of funding gaps and the associated need for external financing. The

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103 IMF (2004, 8).

104 One important instrument used for medium-term expenditure planning is the so-called Medium Term Expenditure Framework (MTEF), which only a limited number of countries have already prepared or implemented. See Holmes / Evans (2003). The framework is used to align the budget-planning process to political-strategic priorities and to ensure that medium-term funds are allocated in keeping with these priorities. The MTEF concept consists of three pillars: a medium-term estimate of the financial resources available; a medium-term cost estimate for sector programs; and the political-administrative decision-making process involved in coordinating available resources with resource needs. See Le Houerou / Taliario (2002, 2ff.); Leiderer (2004, 9 f.).

macroeconomic data needed to estimate financing needs were available in these cases. On the other hand, attempts to calculate the external financing needed to implement a given PRS remain problematic as long as a country lacks an appropriate system of budget planning, and data on the share accounted for by support in a given budget are not particularly viable.

As far as the way in which donor contributions are embedded in the PRSP and budget calendar is concerned, a study conducted by the Strategic Partnership with Africa (SPA) on 18 sub-Saharan African countries found a number of substantial deficits.<sup>105</sup> Even in countries whose PRSP cycles are coordinated with their national budget calendars, it is difficult for donors to align their contributions with national procedural sequences. In nearly all ACP countries the EC is part of a group of budget-support donors whose aim it is to provide assistance on the basis of coordinated procedures. The experience made thus far indicates that alignment with national calendars is problematic above all when a country is already cooperating closely with the World Bank and the donor group aligns its missions with the Bank's PRSC appraisal talks. Incongruencies between donor missions and decisions and national PRSP and budget calendars have been a problem in e.g. Ethiopia, where the donor group has only recently been constituted and is aligning its activities with the procedures of the World Bank (see Box 3).

Some donors have noted critically that the variable tranche concept undercuts the predictability of the EC's budget support. This charge is unjustified because, in the ideal case, the size of the variable tranche for financial year  $n+1$  is determined in year  $n$ , which means that partner governments are informed before the financial year gets underway of the amount to be disbursed. Should this not be the case, the reason will as a rule have to be sought not in the adoption a variable tranche per se but in the fact that the program is insufficiently embedded in the budget calendar, as e.g. in the case of Ethiopia.

To sum up, in its budget-support guidelines the EC set the course for embedding EC budget support in the PRSPs of partner countries. Some deficits encountered in implementing the EC's performance targets are due to both weaknesses in partner countries, e.g. problems with the quality of PRSP

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105 See SPA (2004).

monitoring, and difficulties on the part of the EC in keying its work to national calendars, despite the timeframes it itself sets. Really all contributions of the donor group to which the EC belongs are affected by this lack of alignment with the PRSP and budget calendars of partner countries. It often takes several budget cycles to optimally align budget support with national procedural sequences. The EC is, generally speaking, very willing to continue on the course it has set out and to orient its activities to national calendars.

### 4.3 Conditionality reform

In the framework of its new budget-support concept the EC has undertaken a comprehensive reform of its practice of conditionality. Since 2000 the EC has conditioned its support no longer on the implementation of policy measures, but on outcomes. The new approach is a reaction to the disappointing experiences made with traditional conditionality in the context of structural adjustment:

- In the past, conditionalities were often too detailed. This, together with a lack of donor coordination, frequently led to the formulation of incoherent and not very plausible conditionalities that recipient countries saw more as a necessary ill than as a useful reform strategy.<sup>106</sup>
- Generally, conditionalities were about enforcing macroeconomic measures, which did little or nothing to improve social services for the poor.
- The ‘stop and go’ character of the system, in which tranches were either disbursed in full or else completely deferred, disrupted the budget process in the partner countries.
- Traditional conditions were an obstacle to reform ownership by the recipient countries. The rules, after all, were determined externally. However, sufficient ownership is a sine qua non for the success of reforms.<sup>107</sup> In the long run, imposed measures that lacked the backing of national stakeholders have seldom been able to exert sufficient and durable influence on national policies.<sup>108</sup>

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106 See Adam et. al (2004, 2).

107 See Kahn / Sharma (2001, 13 ff.).

108 See, among others, Morrissey (2004, 168); DFID (2004, 6).

Against this background, the new EC approach is meant to strengthen the result orientation of both donors and recipients. Furthermore, the idea is to ensure that the government in question has scope for policy choices, with donors taking a back seat in matters of program implementation. The aim is to encourage national accounting systems and to reward successful policies, while conditionalities are expected to be derived from the PRSPs. The EC for the first time integrated performance-based conditionality in a budget-support program in 1999, in connection with a pilot project on conditionality-reform in Burkina Faso, and it has since gradually transformed its practice of conditionality.<sup>109</sup>

### 4.3.1 Evaluation levels and introduction of outcome indicators

In determining the particular conditionalities for budget support, the Commission identified four stages of development cooperation: input, output, outcome and impact.<sup>110</sup> Indicators are defined in such a way as to make evaluation possible at the various levels.

- **Input indicators** measure the actions and financial, administrative, and regulatory resources which are put into the development process; these may include e.g. seminars, workshops, working time, adoption of legislation, etc. Conditions at the input level are also referred to as process conditionality.
- **Output indicators** measure the concrete and immediate consequences of the measures taken and resources used (these may include e.g. the number of schools built or teachers trained).
- **Outcome indicators** measure the results and positive changes at the target-group level. Alternatively, the terms results or performance indicators are used instead (these may include e.g. school enrolment rates, the percentage of girls who have been enrolled in school).
- **Impact indicators** measure the actually intended impacts or the paramount objectives of an intervention, which as a rule is based on several outcomes (literacy rate, unemployment rate, etc.).

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109 See Zongo / Coulibary (2000).

110 See EC (2000d, 3).

In its budget support programs, the Commission focuses on outcome indicators (Fig.2). Conventional conditionality focussed on the implementation of policy measures and their direct effects, but this has done very little to improve social services for the poor. It has become evident that increases in health budgets or the construction of new health centers does not necessarily mean increases in the number of patients treated. In Burkina Faso the number of clients even decreased in spite of additional health centers.

It therefore makes sense to use result/outcome indicators. Furthermore, results-based conditions increase the partner countries' autonomy by safeguarding their scope in regard to the means and methods applied. This is intended to strengthen partner ownership of programs and to induce partner governments to focus on the situation of target groups. Since many result indicators reflect changes in the provision of social services, which can be assessed by the population, these indicators are also better suited for accountability purposes than input indicators. While impact indicators would be preferable in the sense that they address the overarching goals of development, they are difficult to define and their use only makes sense over the long-term. They are for this reason rarely applied.

In its budget-support programs the EC's aim is to concentrate on outcome indicators: "The purpose of the [...new approach] is to evolve from the traditional conditionalities (requiring governments to implement measures/conditions) towards performance indicators."<sup>111</sup> However, it has restricted the use of outcome indicators to the variable tranche, which is targeted to sectors defined as priority: "Such indicators may be designed to reflect improvements in public services offered to populations in the health and education sectors and improved efficiency in certain sectors, such as justice and especially the management of public finances, which are deemed to be priority sectors."<sup>112</sup> Process conditionalities continue to be required for the fixed tranche.

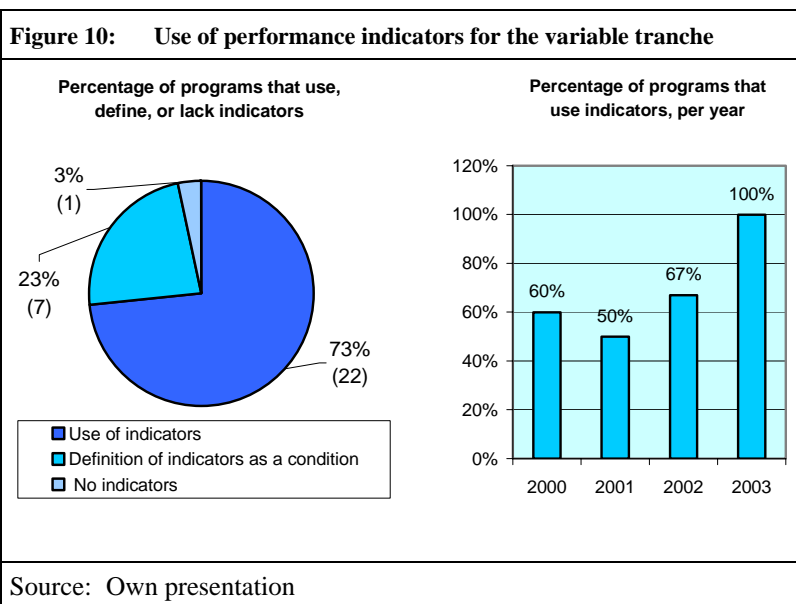
In recent years outcome-oriented conditionalities have become an important building block of European budget support. 73 % of the EC's budget-

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111 EC (2002, 3).

112 Ibid. For indicators in the field of public financial management, the EC indicates, in some documents and diagrams, its intention to use *efficiency indicators*. The term has, however, not been defined.

support programs condition disbursement on – among other things – performance-based indicators. A further 20 % of programs call on partner governments to formulate a list of outcome indicators and to coordinate them with the EC. Only then are the funds released. Only a limited number of financing proposals make no reference at all to performance-based conditionalities. Furthermore, the number of programs that provide exclusively for traditional conditionalities has been constantly declining. In 2003 all of the budget support approved by the EDF contained performance-based elements (Fig. 10).

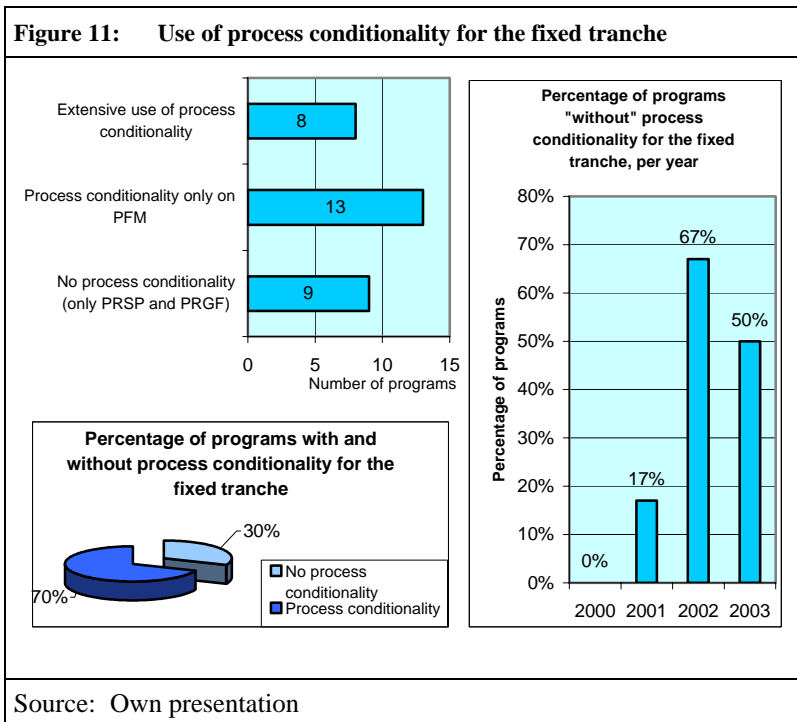


The release of the fixed tranche, which is used for purposes of macroeconomic stabilization in partner countries, is oriented to economic reform programs coordinated with the BWIs (Fig. 11). The conditions set have process character and are keyed first to satisfactory implementation of the BWI macroeconomic programs and second to progress in the PRSP process. The EC's aim is to avoid any more extensive conditionalities.<sup>113</sup> The

113 See EC (n.d., 2).



majority of the fixed tranches of the budget-support programs adopted by the EDF Committee between 2000 and 2003 contain conditionalities that go beyond the two criteria referred to above. Thirteen programs set additional conditionalities for public financial management, seven formulate additional conditions for other core sectors like education and transportation. To cite an example, in Benin disbursement of the fixed tranche is conditioned on presentation of a strategy paper for the education sector.<sup>114</sup> The Rwandan program additionally links disbursement of the fixed tranche to indicators for the judicial sector as well as for regional integration.

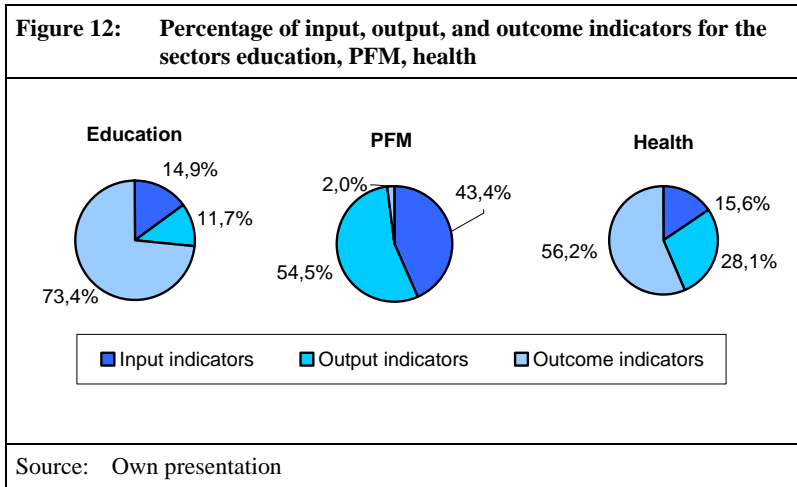


114 See Benin/358, 6.

Table 3 sums up the way in which conditionality reform has been implemented. What we see is a clear-cut trend toward programs that both specify no detailed policy measures for the fixed tranche and use outcome indicators for the variable tranche. But even in 2003 some programs were adopted that still contained process conditionalities. In addition, implementation of performance-based elements does not mean that all variable-tranche indicators are outcome indicators. On the one hand, it is difficult to define outcome indicators for certain priority sectors such as the public financial management; on the other hand, input indicators are still often defined for the health and education sectors.

<b>Table 3: Introduction of the new conditionality in the EU's budget support programs</b>			
<b>Fixed Tranche</b> <b>Variable Tranche</b>	<b>No process conditionality</b>	<b>Process conditionality only for public finance management</b>	<b>Extensive use of process conditionality</b>
<b>Use of indicators</b>	<b>8 programs:</b> Benin 379, Burkina Faso 358 and 370, Ethiopia 373 and 377, Jamaica 373, Mauritania 359, Tanzania 376	<b>6 programs:</b> Ghana 365, Mali 379, Mozambique 372, Niger 376, Rwanda 378, Zambia 379	<b>6 programs:</b> Benin 358, Chad 358, Guinea Bissau 354, Lesotho 359, Rwanda 358, Zambia 353
<b>Definition of indicators</b>	<b>1 program:</b> Kenya 356	<b>6 programs:</b> CAR 358, Chad 378, Jamaica 360, Mali 365, Mozambique 358, Tanzania 360	<b>2 programs:</b> Burundi 373, Cameroon 358
<b>No indicators</b>	<b>0 programs</b>	<b>0 programs</b>	<b>1 program:</b> Ethiopia 364
Source: Own presentation			

The transition to performance-based conditionality is most clearly marked in the education sector. 73.4 % percent of education-related indicators are outcome indicators, whereas output indicators are dominant in the area of public financial management. Only 2 % of these indicators can be re-



garded as outcome-oriented. In all, 43.2 % of the indicators used for the variable tranche are outcome indicators (Fig, 12).

On the whole, there is still room to expand the use of performance-based conditionality, even though problems involved in defining outcome indicators for public financial management make it unlikely that process conditionalities will be completely abandoned for the variable tranche.

### 4.3.2 Outcome-oriented tranche disbursement

One innovative aspect of the EC approach to budget support is the gradual reduction of payments when the performance of recipient countries remains unsatisfactory. Generally, the situation in partner countries is neither completely satisfactory nor completely disappointing. The Commission has shifted from a binary (“yes/no”) allocation system to a continuous

("more or less") system which provides for disbursement of the variable tranche keyed to the results achieved by partner countries.

The idea of the new approach is to improve the predictability of support and to strengthen its credibility.<sup>115</sup> In cases of poor performance the performance-linked variable tranches of pluriannual EC programs are not suspended but reduced in part, an approach that serves to enhance the planning stability of partner governments. This model permits the EC to respond flexibly to partner weaknesses and at the same time to enforce the conditions set. In the past conditionalities have often been undermined at the expense of their credibility so as not to endanger the continuation of support.

Allocations are calculated as follows. First, a certain share of the tranche is assigned to each indicator. If the objective expected is achieved, this partial amount is paid out in full. If there has been progress, though not as much as expected, only half of the tranche is disbursed. If the results are unsatisfactory, the money is withheld (Fig. 3). Each indicator thus contributes to determining the total amount of the variable tranche to be transferred.

Thorough consideration should be given to the weighting assigned to the various sectors and the sum allocated to each individual indicator.<sup>116</sup> The consequence of poor performance in one sector or on one indicator is reduction of the variable tranche. As a rule the indicators are weighted equally within each sector.<sup>117</sup> If e.g. five indicators are defined for a given sector, each indicator has a weight of 0.2. If a beneficiary country fails to meet one indicator, it will receive 20 % less of the funds made available for the sector.<sup>118</sup> Only in a small number of cases do financing agreements assign special importance to certain goals within a sector, giving them greater weight than others. To cite an example, Tanzania receives 10 % of the sum earmarked for public financial management if it conducts anti-corruption measures, whereas 20 % of the same sum is conditioned on preparation of the budget (see Tanzania/376). In Benin the number of

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115 EC (n.d.), 7; EC (2004a, 10).

116 See AIDCO / DEV/ RELEX (2002, 43).

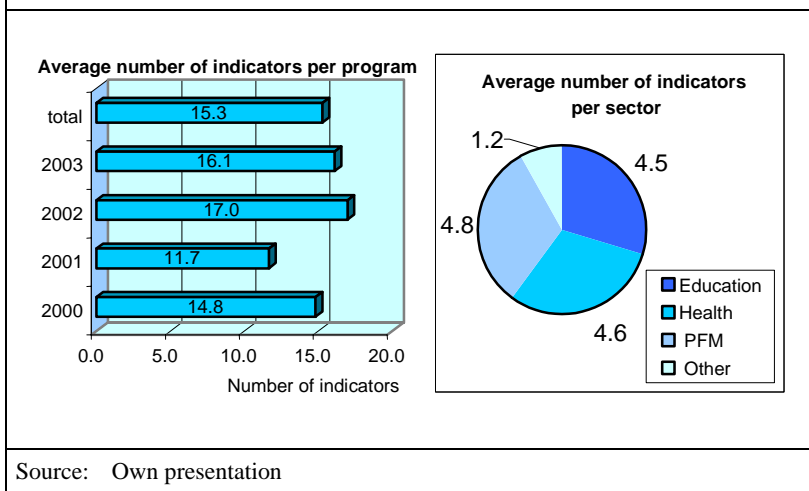
117 See the programs Benin/358; Burkina Faso/358; Guinea Bissau/354; Mali/379; Chad/358.

118 Accordingly, a tranche is calculated on basis of the formula  $(n/a) \times b$ .

assisted births is weighted higher than a rising health budget (see Benin/379).

If we look at the variable tranche as a whole, we find that the indicators associated with public financial management are weighted higher than the indicators for education and health. On average, 4.8 indicators are defined for public financial management, and this, assuming that all indicators are weighted equally, would mean an allocation of 31.7 %. In all, however, nearly 39 % of funds are linked to conditions in the area of public financial management, as is indicated by the percentaged distribution of the variable tranche across the individual sectors. One quarter of the funds available is planned in for the health and education sector. Compared with the structural adjustment aids of the past, the number of indicators is both low and in line with the demand that disbursement should be linked to a low num-

**Figure 13: Number of indicators in budget-support programs**



ber of concrete indicators that reflect the complexity of a given sector (Fig. 13).<sup>119</sup>

As a rule financing proposals contain no substantive comments on the weighting of indicators in the education, health, and public finance sectors.

119 See KOM (2002a, 22); AIDCO / DEV / RELEX (2002, 43).

The same goes for the way in which funds are allocated across sectors. The proposals often make reference only to the importance of priority sectors for poverty reduction or explain the decision to accord special weight to public financial management. It is for this reason not possible to use the financing proposals as a basis for conducting a qualitative assessment of fund allocation.

Decisions on whether targets have been met or not are taken in coordination with the governments of beneficiary countries. The EC is wholly against any purely mathematical interpretation of the indicators. All internal and external effects that may affect goal attainment must be taken into consideration. Possible effects of external factors on goal attainment have to be isolated in order to be able to pinpoint the responsibility of a partner government. Indicators that are not met because of natural disasters or the like are eliminated from the assessment. To cite an example, because of the flood disaster in Mozambique in 2000, the EC did not insist that targets be reached in the education sector.

The indicators were designed to be ambitious enough to reflect progress and realistic enough to ensure that partner sector strategies are in fact supported. This calls for close cooperation with sector experts. Data on the disbursement of the variable tranche indicate that the indicators used are balanced. Between 2001 and 2002 an average of 70 % of the maximum amount of the variable tranche was disbursed. Using the example of Ethiopia, Annex 6 shows how a variable tranche is calculated. In most points the EC delegation and the Ethiopian government reached agreement on the extent to which indicator targets had been met. The parties differed only on two indicators. In all, 64.5 % of the variable tranche was disbursed.

Whether the indicators and targets involved in budget support are appropriate in substantive terms and do justice to the problem situations in individual partner countries is a question that can be looked into only for individual cases and on the basis of a detailed analysis of sector data and strategies.<sup>120</sup> Even so, the most commonly used indicators are embedded in cross-cutting concepts that should be used in preparing financing proposals.

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120 The EC speaks of "SMART Indicators": specific, measurable, accepted by all involved, realistic, timed.

### 4.3.3 Indicator content and explanatory power

Partner ownership is accorded a central role in the discussion on budget support and similar instruments. If these cannot be assumed for a partner, there is no way to ensure that budget support will be put to proper use.<sup>121</sup> If the targets stipulated by donor programs are to do justice to the principle of ownership, they must be coordinated with the strategies of recipient countries. As experience has shown, imposed measures that are not backed by national stakeholders are seldom able to influence national policy in the long run.<sup>122</sup> This is why the EC, in defining indicators and targets for EC budget support, accords priority to ensuring that they are aligned with national strategies. "As far as possible, the indicators should be identified in the PRSP or the governments policy documents."<sup>123</sup> Many PRSPs contain a list of indicators that can be used to derive the indicators for EC budget support. A one-to-one adoption of such indicators is not recommendable only in the case that the way in which PRS matrices or targets have been prepared still appears uneven or changes are already anticipated for some targets. The indicators and/or targets for many first-generation PRSPs have been adapted over the course of time, a fact that makes it difficult to use these data for orientation. Furthermore, most poverty strategies do not define targets for public financial management, which means that PFM indicators must be taken from other strategy papers.

The majority of financing proposals note that indicators have either been taken from PRSPs or are based on them. Statements like this, however, do no mean that any 100 % conformity with partner poverty strategies is necessarily given. Although e.g. the financing proposal on Burkina Faso explicitly notes that the indicators used for the EC's budget support were selected from the country's PRSP, only six of nine indicators for the health sector were consistent with the PRSP matrix. There were also three indicators that were not mentioned in the country's PRSP. By contrast, the indicators for Mozambique's health and education sectors are identical with those set out in the country's PRSP. A small number of financing proposals aim solely for "coherence" with the indicators from partner PRSPs.

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121 See Berke (2002, 2f.); Brown et al. (2001, 8 ff.).

122 See i.a. Morrissey (2004, 168); DFID (2004, 6).

123 See AIDCO / DEV / RELEX (2002, 43).

Only in exceptional cases do financing proposals fail to make any statements at all on the PRSP relevance of indicators (e.g. Chad/378).

On the whole, the EC's budget-support programs still make too little use of PRSP indicators. One reason for this is that the PRSP matrices are often prepared under considerable time pressure and do not meet the standards for relevant outcome indicators. On the other hand, though, this is also a clear sign of how difficult it is to accord serious attention to the ownership and policy-shaping capacities of partner countries in relation to development goals and to consistently align budget-support programs to national strategies. In the coming years, once the first three-year cycle has come to an end, many partner countries will be developing a new generation of PRSPs that make use of the results of the PRSP evaluations available and will be expected to address the weakness of the first-generation PRSPs. In many countries the continuing discussions on lists of the most important indicators will by then have led to the formulation of sound matrices that are used in the second-generation PRSPs and make it easier for the donors to apply their PRSP indicators.

As a rule PRSPs constitute a planning framework for all important policy fields, and most PRSP matrices are accordingly comprehensive. It can also be observed that many PRSPs contain a highly detailed list of indicators instead of concentrating on a small number of core indicators. In selecting indicators from these PRSP matrices, the EC seeks orientation in the MDGs adopted by the international community in the UN's Millennium Declaration of September 2000. In monitoring the eight MDGs, UNDP uses 48 indicators which are also used in EC budget-support programs – assuming they occur in a given PRSP. With a view to further specifying the European approach, the EC has furthermore issued a set of monitoring guidelines for the health and education sectors which set out the most important indicators.

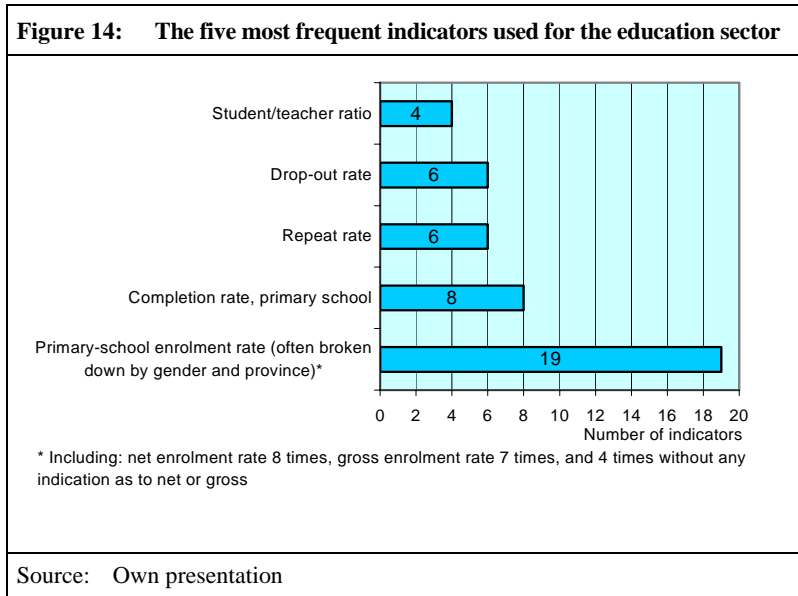
As regards education, the EC distinguishes three aspects that are required to assess progress in the education sector: access to education, educational system efficiency, and learning results.<sup>124</sup> Access to education is measured on the basis of net or gross enrolment rates. Enrolment rates are important indicators in the context of the MDGs, and this parameter also figures

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124 See EC (2003d, 6 ff.).

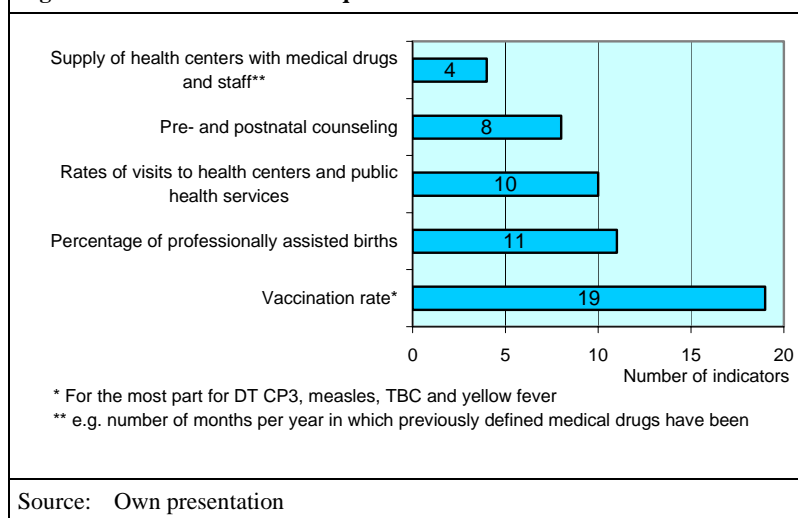


importantly in the EC's budget-support programs, turning up in 19 of 30 financing proposals. But neither of the two enrolment rates indicates how many years of schooling students actually complete. In the extreme case, rising enrolment rates may go hand in hand with declining figures for years of schooling actually completed. It therefore makes sense to couple the "enrolment" indicator with an indicator that measures educational system efficiency and contains information on completed years of schooling. "Primary-school completion rate" or "percentage of first graders who reach the fifth year of schooling" are used as alternatives. The majority of financing proposals provide for a combination of access and efficiency indicators. It is more difficult to measure educational levels or the learning results achieved by students in different educational systems. Some financing proposals seek to do justice to this need by monitoring the ratios between students and teachers (Fig. 14).



The EC's orientation guide on measuring progress in the health sector makes reference to MDGs four, five, and six and recommends the following outcome indicators for EC programs and country strategies: percentage of one-year-olds vaccinated against measles, percentage of one-year-olds with a complete set of vaccinations, percentage of assisted births, percentage of the population covered by the social security system, and dissemination of contraceptives. Most financing proposals make reference to vaccination rates and assisted births and focus on reduction of child and maternal mortality (Fig. 15).

**Figure 15: The five most frequent indicators for the health sector**



No orientation guides have been issued for other priority sectors. As far as public financial management is concerned, the EC orients its efforts to the work of the PEFA initiative (see Chapter 4.5).

If indicators are to come up with reliable information on the development of priority sectors, there is a need for efficient systems for collecting and processing statistical data. Only a small number of financing proposals make reference to the quality of the data on which they are based.<sup>125</sup> On the other hand, most mention the sources on which monitoring is to be based. Furthermore, the TC components of most programs provide for efforts to strengthen monitoring systems.

#### 4.4 Assessing public financial management in partner countries

##### 4.4.1 Public financial management in program-oriented development cooperation

The debate on a more marked program orientation of DC has now come to focus on the quality of public financial management in partner countries. The effectiveness of public financial management is relevant in two different respects. On the one hand, the high fiduciary risks involved in providing budget support and similar instruments calls for a certain minimum level of transparency, effectiveness, and efficiency of public financial management to ensure that the instruments are used successfully. Only the other hand, it is precisely the provision of budget support and flanking measures that is expected to contribute to strengthening public financial management by promoting reforms in partner countries and easing strains on national capacities. The aim here is – not least – to boost the effectiveness of partner governments in implementing their PRSPs.

We can distinguish here seven basic elements of public financial management that are relevant in providing budget support:<sup>126</sup>

- shaping the institutional and legal budget framework;
- strategic planning and budget formulation;
- budget preparation;
- budget implementation;

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125 See e.g. Burkina Faso/370, Ethiopia/368.

126 See i.a. Leiderer (2004), World Bank (1998), World Bank (2003).

- accounting and monitoring;
- financial reporting and auditing;
- information management, provision of technical and personnel capacities.

Developing countries are typically faced with a number of financial management problems that adversely affect the quality of budget management as regards these seven elements. Most of these problems are due to lacking or inadequate institutions, limited technical or personnel capacities, and governance deficits.<sup>127</sup> One particularly serious problem must be seen in the need to reform public budget systems in the HIPCs. This is the finding of a joint study conducted in 2002 by the IMF and the World Bank that looked into whether and to what extent poverty-targeted funds can be tracked on the basis of existing national budget management systems.<sup>128</sup> For 15 of the 24 countries it covered, the study found substantial weaknesses in public financial management, and for the remaining nine countries it found some deficits that are in need of improvement. Numerous countries have, with donor support, already initiated comprehensive reforms designed to gradually improve their budget systems. The EC is participating in this process by monitoring and assessing the both weak points in public financial administrations and progress that has been made in connection with budget-support programs.

#### 4.4.2 Assessing public financial management in the framework of EC budget support: instruments and principles of action

In its Communication of February 4, 2000, on structural adjustment aids, the EC sees in the quality of public financial management an important key to the success of untargeted budget support in the ACP countries. In its Special Report 5/2001, the European Court of Auditors follows this view and recommends that improvement of public financial management be accorded high priority. It recommends that budget support be conditioned on a detailed analysis of the strengths and weaknesses of the finan-

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127 See Leiderer (2004, 7 ff.).

128 See IMF / IDA (2001).

cial administrations of partner countries that leads to a reform strategy. Second, it calls for continuous and donor-coordinated assessment and documentation of progress in public financial management. The Court of Auditors calls on the EC to take measures and to develop instruments that can be used to assess the quality of public financial management and the actual progress that has been made in this area.

In its guidelines on the provision of budget support, the EC defines the principles and instruments to be used in assessing public financial management in partner countries. The guidelines see an *ex ante* assessment of public financial management as an essential eligibility criterion for budget support. This assessment should cover the following areas:

- description and analysis of the legal and legislative framework;
- review of flows of funds, in particular to the social sectors;
- assessment of the reporting and monitoring standards of internal and external auditing institutions;
- selection of performance indicators for public financial management.

This *ex ante* assessment of public financial management is expected to be conducted using the customary diagnostic tools developed in particular by the BWIs in the 1980s and 1990s (CFAA, PER, CPAR, ROSC, etc.). Together with other donors, the EC is in favor of systematically involving partner countries in conducting these analyses or making targeted use of them in preparing financing proposals. "The assessment of public finances should be based on work already done by the country on its own or jointly with other donors."<sup>129</sup> Such diagnoses of public finances have already been conducted for most partner countries. Wherever this is not the case, the EC, if possible together with other donors, will conduct comprehensive analyses prior to granting budget support. The summary *ex ante* assessment is expected to be appended to every financing proposal and to explain what diagnostic procedures the assessment is based on.

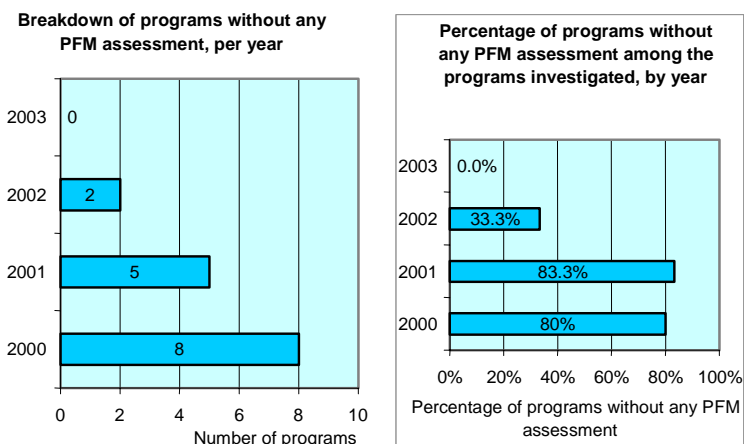
Thus far the financing proposals have not devoted sufficient attention to public financial management systems. Only half of all financing proposals contain an assessment of the public finances of the partner country under consideration. Considerable improvements have, though, been noted in

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129 AIDCO / DEV / RELEX (2002, 39).

recent years. While not one of the financing proposals approved in 2000 contains a comprehensive analysis of the public financial management systems in question, all of those prepared in 2003 are accompanied by a diagnosis of public financial management (Fig. 16).

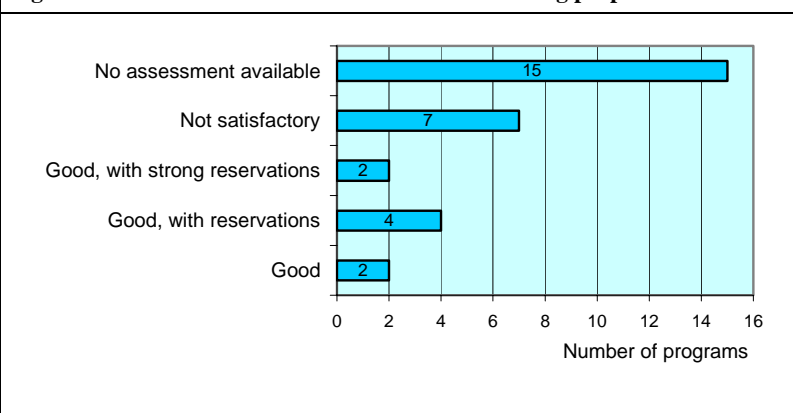
**Figure 16: Assessment of PFM in budget-support-related financing proposals**



Source: Own presentation

The EC is fully aware that many ACP countries have weak PFM systems. But it is the provision of budget support in the first place that legitimizes a comprehensive dialogue between donors and partner governments on central issues of budget management. "The improvement of PFM is therefore not so much a pre-requisite as a fundamental objective of direct budget support, to be gradually reached through a dynamic process."<sup>130</sup> Most of the analyses contained in financing proposals come to the finding that the quality of public financial management in the countries concerned ranges from unsatisfactory to good, though in most cases with strong reservations (Fig. 17).

<sup>130</sup> EC (2004a, 14).

**Figure 17: Results of PFM assessments in financing proposals**

Source: Own presentation

During program implementation the EC monitors the quality of public financial management and the actual progress of reforms in partner countries. The following measures have been stipulated for purposes of regular review:

- Since September 2003 the EC delegations in recipient countries have been required to present **semiannual** monitoring reports on partner public financial management; these reports are prepared in a standard format stipulated by Brussels.
- **Annual assessments** are used to review the overall situation of public financial management and appraise weak points in financial administration that have been identified in previous reviews. The annual assessment requires an approach coordinated with all donors.

For the annual assessments the EC basically recommends the use of three instruments:

- Cross-cutting assessments of public financial management, e.g. in the framework of annual reviews on the implementation of PRSPs or based on the traditional diagnostic procedures of the BWIs (CFAA, CPAR, ROSC, etc.).

- The diagnoses are supplemented by compliance tests and audits that serve to review actual expenditure and its conformity with the valid regulations and procedures.
- Definition and annual review of performance indicators for public financial management are used to verify reforms in this area.

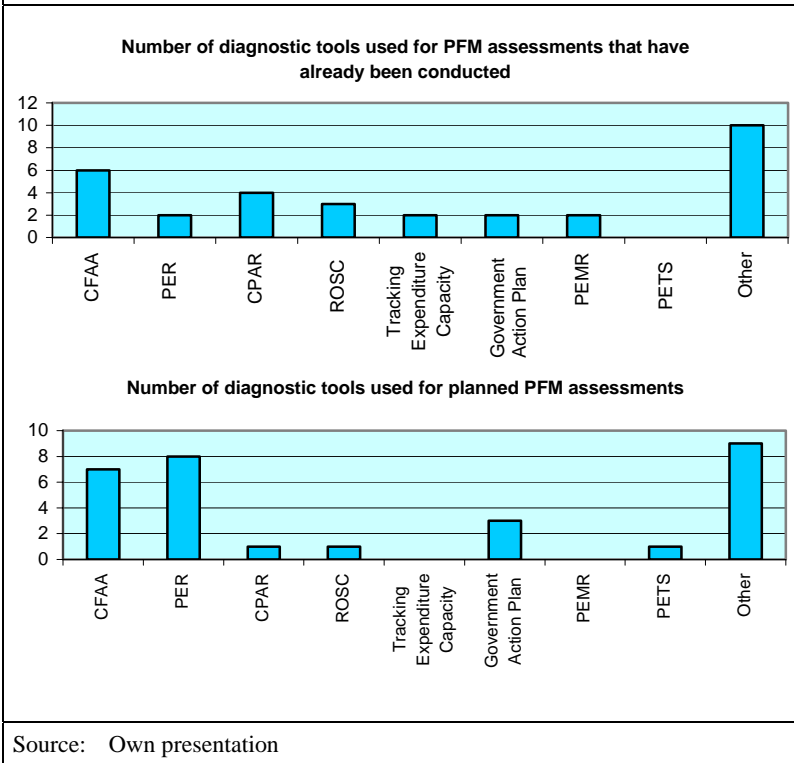
Thus far, the financing proposals presented have been patchy in their statements concerning the continuous analysis of PFM. In the future diagnoses of public financial management will be required for 19 of 30 programs. All proposals approved in 2002 and 2003 made reference to the need for continuous analysis, while only two of ten program proposals presented in 2000 has anything to say about future assessments of public financial management. For only roughly 40 % of programs are there any plans to conduct compliance tests (Burkina Faso, Mozambique, Tanzania, Zambia).

The EC makes use of a good number of instruments to assess partner PFM-systems, as a rule in coordination with other donors. Figure 18 shows that only roughly one half of the diagnoses conducted are based on CFAs, PERs, or CPARs. Other diagnostic methods and sources of information also play an important role here, including e.g. studies that are conducted in the framework of a reform program (Ethiopia), focus on certain details of a public financial management systems (Chad), or serve as pilot studies for the design of a universal analytical framework (Zambia).

One difficulty involved in analyzing public financial management is that the set of instruments commonly used has not yet been integrated to form a coordinated system of individual assessment modules. The individual tools differ in terms of object of investigation, methodology, and depth of analysis, and for this reason only some of them can be used in a complementary fashion. A given donor's choice of an instrument on which to base his financing activities can entail differences in assessments of partner weakness and progress in the field of public financial management. This makes it difficult to reach agreement on action plans for the reform of public financial management that are backed and monitored by all donors involved. The EC is for this reason working together with other donors on the development of a comprehensive analytical framework that integrates



**Figure 18: Number of diagnostic tools used for PFM assessments that are planned or have already been conducted**



the existing analytical tools and is used by all donors. Together with the World Bank, the IMF, and DFID, the EC has developed the so-called Public Expenditure and Financial Accountability (PEFA) program, at present without doubt the most important initiative designed to improve and harmonize the analysis of public financial management in developing countries. The objective of PEFA is to work out and adopt a universal and partner-coordinated diagnostic procedure, the so-called Standardized Assessment, which is based on a limited number of indicators.<sup>131</sup> A standardized diagnostic procedure would facilitate coordination of an overall plan

131 See e.g. PEFA (2003).

for public financial management reform and serve as a basis for the dialogue between donors and partner governments on budget management.

In formulating indicators and targets in this field, the EC has until now relied on the customary analytical tools and the action plans agreed on in connection with them. The EC's financing proposals contain an average of roughly five conditionalities for PFM. The most frequently used indicator is the rate of budget implementation in priority sectors (17), followed by target criteria on budget allocation (11) and budget implementation at the decentral level (9). Most of these indicators are contained in the list of 28+2 indicators recommended by PEFA for reviewing budget management. With a view to making headway in harmonizing analytical procedures, the EC is presently coordinating ten of 17 pilot projects that are set to be used to test the standardized PEFA procedure. Eleven of these pilot projects are being conducted in ACP countries in which the Community provides budget support (e.g. Burkina Faso, Benin, Madagascar, Tanzania).<sup>132</sup>

It may be said by way of summary that direct and untargeted budget support is sustainable only if it is accompanied by continuous improvements in public financial management. In view of the fact that a good number of changes are in the making and capacities in recipient countries are limited, the task of implementing PFM reforms in partner countries is proving to be a complicated and protracted process. The risks bound up with the provision of budget support can be reduced only gradually, by monitoring and supporting the actual reform processes in partner countries. The EC is fully aware of this situation and has laid the groundwork for efficient and "low-risk" budget-support programs with its general emphasis on PFM as well as with its concrete targets for use in reviewing and accompanying PFM reforms. However, implementation of the targets and assessment of progress on reforms call for development of expertise in headquarters and delegations on the one hand and concerted action on the part of all donors on the other. The EC has introduced comprehensive advanced staff training and training courses as a means of improving analysis quality. In addition, the staff of delegations is provided support by headquarters PFM experts or professional external experts. Even so, the personnel resources available to the EC are not sufficient to conduct an overall assessment of

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132 See AIDCO / DEV (2004).

PFM and actual progress on reforms without coordination with other donors. This applies not only for the EC but for most other budget-support donors as well, a fact which serves to underline the importance of donor coordination.

#### 4.5 Donor coordination and EC budget support

In connection with the ongoing debate on budget support, donor coordination has become a key issue on the international development agenda. The background must be seen in the great number of procedures and structures that have been used in the past by donors of development aid – and have led to considerable strains on the capacities of partner countries. Empirical experience clearly shows that inadequate donor coordination in the implementation of projects and programs leads to higher transaction costs for both donors and recipients and undercuts the effectiveness of DC. The aim of donor coordination is to counteract these effects and to align DC contributions with strategies formulated by partner countries on their own.

There are at present a number of initiatives underway in the field of donor coordination. The OECD's Development Assistance Committee (DAC), whose members include both the EC and the EU member states, has worked out a number of detailed recommendations that were adopted in February 2003 by numerous donors and developing countries in the Rome Declaration on Harmonisation.<sup>133</sup> The DAC has since created a working group on donor harmonization; the group has developed a limited number of harmonization indicators and assembled a summary list of good practices. At the country level, the World Bank is engaged in work in 11 countries aimed at bringing about donor harmonization.<sup>134</sup> A number of donors have also presented action plans on donor harmonization (Germany in April 2003).

For its part, the European Community has committed itself to the goal of donor coordination. At the Council meeting in Barcelona all EU member countries came out in favor of undertaking concrete steps toward a joint approach. "[The EU Member States agreed to] take concrete steps on co-

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133 See OECD / DAC (2003).

134 See World Bank / DAC (2003).

ordination of policies and harmonisation of procedures before 2004, both at EC and Member States level.<sup>135</sup> The Ad Hoc Working Party on Harmonisation recommends that efforts be undertaken to speed up the implementation of the harmonization commitments agreed to in the Rome Declaration and calls on the European Commission and the member states to participate in all multi-donor initiatives in partner countries. A particularly important role is seen for donor coordination in connection with budget support.

The budget support the EC provides is geared to supporting macroeconomic reforms and reducing poverty in partner countries. As a rule, several donors provide support for partner national PRSPs, which means that the EC's budget support is complementary to the budget aids provided by other donors. "The Commission expects to co-finance all support for PRSPs and economic reform and/or sector programmes together with the World Bank, the EU Member States, or other bilateral donors."<sup>136</sup> And macroeconomic reform programs and PRSPs call for DC contributions that are coordinated and harmonized by the donors. "This will be reflected in the negotiation between government and donors of a single framework of support in which the same objectives, disbursement schedule, conditions/verification indicators will apply."<sup>137</sup>

In connection with the support they provide for PRSPs, donor groups have in recent years been constituted in numerous ACP countries to harmonize donor contributions. Donors groups have already been set up in ten countries to coordinate general budget support.<sup>138</sup> While some of these groups are no more than informal associations, most of them work within an institutionalized arrangement, the so-called joint partnership framework. It defines the basic principles and in some cases also the mechanisms to be used in assessing and documenting the progress made by the partner countries concerned (the so-called performance assessment framework).

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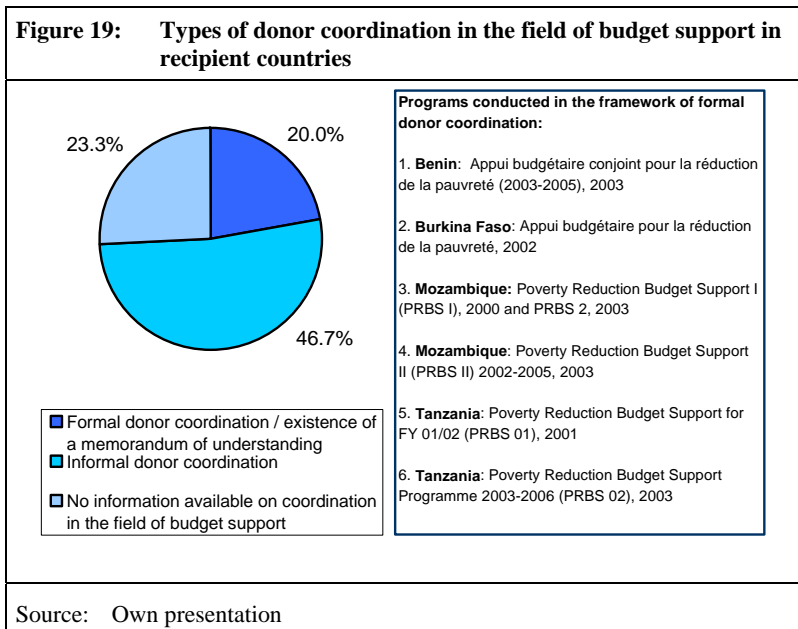
135 Council of the European Union (2002, 1f.).

136 AIDCO / DEV / RELEX (2002, 36).

137 Ibid.

138 Ethiopia, Benin, Burkina Faso, Ghana, Malawi, Mozambique, Rwanda, Senegal, Tanzania, Uganda. In the spring of 2004, groups of budget-support donors were in preparation in Madagascar, Zambia, and Kenya.

The EC is a member of all of the budget-support groups presently operating; its aim here is to institutionalize cooperation. According to the guidelines, the type and substance of inter-donor cooperation should be set out in written form and appended to the financing proposals. At present roughly 20 % of all programs are being carried out in the framework of a formalized donor group, and informal arrangements are sought and concluded with other donors for approximately half of all programs. Only a limited number of financing proposals contain no information on donor coordination (Fig. 19).



Despite the appreciable progress that has been made, there is still room for improvement of donor coordination. Joint implementation of budget-support programs contributes to focusing the political dialogue with partner governments on a limited number of important issues and aligning donor contributions with partner PRSPs. This is the case in particular when the donors adopt the frame of reference normally used to monitor PRSPs and to assess country progress and disburse budget support. What this means in effect is that donors are forced to relinquish some of their

own claims in formulating conditionalities. Thus far only some success has been achieved in reaching agreements on a limited number of conditionalities derived from partner PRSPs. The reason for this must be sought in divergent views on the significance and quality of individual indicators as well as in doubts as to the appropriateness of national targets.

One important step on the road to a harmonized conditionality policy is to agree on reduced matrices for PRSP indicators, a step that has already been taken by some donors groups together with partner governments (Tanzania, Mozambique, Ethiopia). The question as to which PRSP indicators are regarded as especially relevant and thus incorporated in a matrix hinges in large measure on the priorities of individual donors. While the EC has expressed its preference for outcome indicators, the World Bank in particular has come out against conditioning budget support on outcome indicators. In its opinion governments cannot be held directly responsible for the outcome of policy measures at the user level. On the other hand, it notes, it is possible to identify and track efforts undertaken to implement reforms. The World Bank for this reason conditions the disbursement of its PRSCs on a limited number of process indicators, or so-called prior actions, which it wishes to see adopted by formalized donors groups. The result is that most matrices contain a broad spectrum of process conditionalities and performance indicators, a development that tends both to undercut the potential benefits of the performance-based approach and to weaken the incentives for a government to concentrate on outcomes.

While the EC and the World Bank condition their disbursement of funds on a limited number of indicators, a small number of bilateral donors specify the matrix indicators to which they attach particular significance. A set of satisfactory overall results is often required for a continuation or disbursement of aid. This entails the risk that incentives may be watered on and partner governments may not, in all cases, be held responsible for lack of progress on reforms. The PAF of the G15 Mozambique donor group contains some 60 indicators which are reviewed in the framework of annual PRSP monitoring. Even today it has become apparent that in 2004 good performance in some areas will be matched by moderate to poor performance in others. Even so, it is unlikely that bilateral donor contributions will be reduced for the following year, since most donors see the overall process as constructive and satisfactory. One approach that can be recommended as a means of coming up with a more differentiated relation

between outflows of funds and partner-government performance would be to define priorities in certain sectors and to adopt what is referred to as graduated response mechanisms of the kind we find in the EC's variable tranche.

Most donor groups have committed themselves to deriving their PAF indicators and targets from partner PRSPs. One exception here is the conditionalities set for public financial management. Most PRSPs deal only marginally with public financial management and the need for reform of financial administrations. A significant part of the political dialogue between donors and recipient governments for this reason extends to questions bound up with the quality of public financial management.

On the whole, focusing donor contributions in the framework of donor groups has served to enhance the quality of the policy dialogue with partner countries. While in the past individual donors, with their own projects and programs, proved unable to exert any significant influence on strategic development issues, the donor groups have developed into important dialogue forums in which recipient governments are able to coordinate their political priorities with the donor community. To cite an example, the Ethiopian government was long reluctant to discuss central issues of development and public financial management with donors. The only exceptions were the World Bank and the IMF, which succeeded in setting accents in Ethiopia's development agenda. It was only in the framework of budget support that other donors – including the EC – succeeded in embarking on a strategic dialogue with the Ethiopian government.

The complexity of the processes that need to be assessed and monitored in connection with budget support requires the donors to identify operational priorities. "Thematic working groups" on certain PRSP- or PFM- related fields of action (Tanzania, Uganda, Mozambique) have proven their value in this context. In Ethiopia there are at present 14 working groups, two of which are concerned with budget-management issues. The G15 in Mozambique breaks down into 23 working group and sub-working groups. This structure makes it possible for smaller donors to represent the donor group in PRS-related subareas and to play a significant role in shaping the political dialogue. As experience has shown, the weight of individual donors is not a direct function of the volume of the funds they provide; indeed, the thematic inputs provided by donor representatives may well prove equally important. As members of a donor group, donors that pro-

vide relatively small financial contributions may find themselves in possession of considerable leverage. One example here would be German FC in Ethiopia: Even though FC accounts for only a small percentage of the overall volume of German DC, it plays a key role when it comes to central issues bound up with budget planning and implementation. Even donors that are not directly involved in direct budget support, and are thus not members of the donors group, are included in discussions at the working-group level.

The EC plays an important role in many donor groups. Both in Mozambique and in Ethiopia it can be seen as the group's lead donor. Together with the World Bank, it chairs the final negotiations with the partner governments concerned and heads – among others – some (important) working groups on budget issues. The EC's input for the political dialogue and the individual working groups is seen in a highly positive light by the other donors involved, while assessments of the efficiency of the EC's specific financing modalities tend to differ. This goes in particular for the EC's outcome indicators and variable disbursement tranches, which some actors sees as undercutting the predictability of aid for partner countries. However, it is precisely in Mozambique that the EC's variable-tranche policy has led to a heightened outcome orientation in national policy. Other deficits, including e.g. insufficient alignment of the EC's budget support with the Ethiopian government's budget calendar, are attributable to the fact that the budget-support group was only recently constituted and still needs to fine-tune its procedures.

## **5 Conclusions and recommendations**

### **5.1 General conclusions**

The central role played by a more markedly program oriented DC in reaching the MDGs has now been acknowledged in the international development debate. In adopting the new approach to DC, however, substantial differences have emerged between donors as regards the scope and the speed of the changes called for. Various donors, including the UK, the Netherlands, and the European Commission, are visibly moving toward program orientation. Other donors, on the other hand, are reluctant to



become involved in program-based approaches and remain skeptical about them.

*Motivation for the provision of budget support in the EC*

The transition to program-based approaches and budget support in the EC's DC has come about in connection with internal evaluations of the Community's development-policy instruments and programs as well as against the background of the ongoing international discussion. The principle reason cited for providing budget support is to improve the efficiency and effectiveness of DC. In the EC's opinion, the following are particularly cogent reasons for providing budget support:

- Budget support gives greater scope for partner ownership and self-reliance. It serves to support strategies and programs worked out by partner countries themselves, and not, as previously, donor-dominated projects.
- The framework provided by budget aid allows the EC to take far more constructive influence on the formulation and implementation of partner policies than is the case with traditional project approaches. Since the funds provided go directly into the overall budget, the EC has a legitimate interest in the quality of public financial management and to take a hand in partner budget planning and implementation.
- Budget support encourages the development of efficient public financial and administrative structures in partner countries and serves to improve accountability.
- Budget support contributes to greater focus on results both among partners and within the EC.
- Budget support is conducive to donor coordination. Embedding donor contributions in national strategies serves to reduce the great number of projects with different process sequences, reports, consultations, and negotiations. This serves to ease the burden on strained partner capacities and to reduce transaction costs for donors and recipients alike.

In view of the high fiduciary risks involved in the provision of budget support, the EC accords high priority to improving the quality of public financial management in partner countries. Aside from preparation of a PRSP and adoption of a macroeconomic reform program coordinated with the BWIs, the EC has defined satisfactory quality of PFM as a general

precondition for the provision of budget support. These eligibility criteria are fundamentally in line with the preconditions set by other donors for budget support. Still, PFM practices continue to leave much to be desired.

### *Central characteristics of the EC's budget-support concept*

With a view to ensuring that its eligibility criteria are met and that the benefits of budget support are fully realized, the EC developed a comprehensive program concept for budget support and incorporated it in the budget-support guidelines it adopted in 2002.

EC's budget support is marked by the following central characteristics:

- As a rule, EC's budget support is direct and untargeted.
- Budget-support programs have multiyear terms (normally three years).
- EC budget support is paid out in several tranches, with a distinction made between fixed and variable tranches. Normally, one fixed and one variable tranche is released each financial year. Disbursement is conditioned on the implementation of a macroeconomic reform program as well as on good results on performance indicators.
- The aim of budget support is to assist partner countries in implementing their PRSPs. This requires the programs to be embedded materially and procedurally in national PRSP and budget calendars.
- The EC's budget support replaces traditional ex ante conditionality with performance-based ex post conditionality. The link between performance and disbursement is established through a graduated disbursement mechanism.
- Improvements in the quality of PFM has become a top priority in EC budget support programs. Donor coordination has become more important than ever before.

### *Application of the guidelines on program implementation*

There is no point in trying to come up with a conclusive assessment of how well this approach works before several years of experience have been made. The same goes for tracking the anticipated effects, e.g. as far as ownership, reduction of transaction costs, etc. are concerned. Many programs designed along these lines are still in their early stages. Never-

theless, some visible results are already emerging. Analysis of 30 budget support programs launched since 2000 revealed the following:

- The transition from indirect, targeted budget support to a direct and untargeted provision has now been concluded. All budget-support programs approved by the EDF in 2003 involve direct, untargeted budget support.
- There is a clear-cut trend toward pluriannual programs. All 2004 budget support programs cover three years. This serves to increase the predictability of support and contributes to continuous reform processes in partner countries.
- The model based on a combination of fixed and variable tranches is now generally accepted. In 2003, for the first time, all EC financing proposals for budget support provided for disbursement based on fixed and variable tranches. In 2003 nearly 50 % of programmed funds were earmarked for the variable "performance bonus." The other half of these funds are provided to partner countries in the forms of the fixed tranche.
- There is scope to better align budget support programs with the PRSPs and budget process in partner countries. This applies in particular for the variable tranche, which is often calculated only after partner budgets have been prepared. Also, many tranches are disbursed not at the beginning but toward the end of the financial year. But problems in embedding budget support in the budget calendar are not invariably due to the variable-tranche model, they are just as likely to be due to an insufficient dovetailing of the PRSP and budget processes in partner countries on the one hand as well as to the generally inadequate alignment of donor contributions with national process sequences on the other. In most partner countries the EC belongs to a group of budget-support donors. While these groups have largely centralized the consultations and negotiations conducted in connection with budget support, they have not yet sufficiently adapted their activities to national budget calendars.
- The need to materially embed budget support in partner PRSPs calls for program conditionalities that are derived from national strategies. Thus far the EC's conditionalities have not been comprehensively harmonized with national goals and objectives, a fact which is due, among other things, to difficulties partner countries have in formulating appropriate PRSP indicators.

- The use of performance-based ex post conditionality is making good headway, though there would be room to expand it. Even in 2003 programs were still being approved that conditioned disbursement of the fixed tranche not only on macroeconomic reform programs but on other policy measures as well. In addition, the introduction of performance-based elements in the variable tranche does not mean that all indicators used are in fact performance-based. The transition to performance-based conditionality is most evident in the education sector. 73.4 percent of the education indicators applied relate to outcomes. In contrast, output indicators are still prevalent for assessing public budgets. Only two percent of the conditions for this sector are results-oriented. Nonetheless, it is unlikely that input indicators will be completely abandoned – nor would this be recommendable. There are, after all, difficulties in defining outcome-indicators in budget matters.
- Linking payouts to performance in a gradual disbursement scheme has proved worthwhile. It has been possible to condition disbursement on a balanced set of goals and objectives that neither strain nor underchallenge development-related partner capacities. On average, 71 percent of the maximum variable amount has been disbursed so far. Initial experience shows that the variable tranches contribute to making partners more results-oriented.
- There is still considerable room for improvement as regards assessment of partner PFM. More attention should be devoted to both ex ante and continuous assessment of partner PFM systems. The same goes for the use of compliance tests prior to and during program implementation, a practice that has thus far been provided for in only a very limited number of programs.
- The task of overall assessment of budget management and provision of flanking support for comprehensive reforms in this sector cannot be the sole responsibility of the EC; indeed, it calls for concerted action on the part of all donors. Assessment and documentation of progress on reforms must be coordinated with donors of budget support as a means of ensuring that future decisions and measures are undertaken on the basis of precise knowledge of the situations actually given.
- Despite considerable progress, donor coordination remains a challenge. The possibilities and limitations of donor coordination should be accorded more attention in program planning and made more transparent in financing proposals. It is essential to continuously sup-

port and promote donor coordination during the course of program implementation. As initial experiences indicate, the EC is willing to relinquish some of its influence in favor of a coordinated approach. The other donors see in the EC an important and reliable lead donor in the provision of budget support.

## 5.2 Conclusions for German development cooperation

### *Conclusions on the development cooperation Germany provides as a bilateral donor*

German DC is likely to become more involved in PGF in the near future. This goes for contributions to basket financing as well as for sector budget support and general budget support. At present the German TC/FC guidelines provide only for cofinancing of the World Bank's PRSCs. While German participation in multidonor budget support groups without a close link to a PRSC is not formally intended, in practice it is possible after consultation with the ministries concerned. Cofinancing of EC Budget support programs in terms of PRSC cofinancing is neither mentioned in the TC/FC guidelines nor practiced.

As a bilateral donor, Germany should look into the possibility of cooperating more closely with the EC. In donor groups the EC has proven to be a reliable and competent lead partner in the field of budget support. The criteria on which it bases its provision of budget support are in line with those of other donors, and as a general rule these criteria are conscientiously observed. Viewed against this background, it would be reasonable to support an enlargement of Germany's engagement to include cofinancing of EC budget support programs, especially in light of the fact that Germany is in a position to wield considerable influence on program approvals at EDF meetings.

However, it would be important to examine whether and to what extent the concept of cofinancing might be abandoned in favor of an autonomous participation of German DC in budget support programs. In the view of political decision-makers, it is in particular the high fiduciary risks involved in the provision of budget support that speak against any enlargement of general budget support and for restriction to PRSC cofinancing. Despite the risks assumed, this reticence must be regarded with a critical

eye in view of the major leverage effects that an individual donor can achieve with the instrument of budget support.

As a member of a donor group of budget-support donors, individual donors can play an important role in shaping the policy dialogue with recipient governments. While in the past each donor, with his own projects and programs, could wield little influence on strategic policy issues, budget support donor groups have developed into important dialogue forums in which recipient governments are able to coordinate their political priorities with the donor community.

- As experience shows, the importance of the role played by individual donors within a donor group depends less on the volume of the funds they provide than on the content-level contributions made by donor representatives. "Small" donors may very well represent a donor group in subfield of PRSs and exert the influence of a lead donor in the fields for which they are responsible.
- One example of a "small" donor playing a lead role in budget support is German's FC in Ethiopia: Even though German FC provides only a small percentage of the overall volume of budget support involved, it plays a lead role in central issues of budget planning and implementation.
- In principle, the objective of donor groups is to avoid assuming the role of exclusive discussion forums and to get other, uncommitted donors involved in the content-level dialogue with partners (e.g. USAID in promotion of the private sector in Mozambique). Still, consultations with partner governments are restricted to a more or less small circle of donor representatives. This serves to reduce transaction costs for donors and recipients alike and can, in this sense, be seen as an approach that is highly reasonable in terms of development policy. Nonmembers of a donor group are unable to use their involvement in given areas to stake out a claim to greater involvement in negotiations if they are unwilling to bear a share of the risks entailed by budget support.

The complexity of the processes that need to be assessed in the framework of the provision of budget support makes it essential that German DC act in the framework of formalized donor groups. What concrete shape should be given to a German participation in donor groups, and whether delegated cooperation in the sense of a closer alignment to the EC's budget-support program might prove reasonable – these are questions that would have to

be answered on a case-by-case basis. Against the background of the EC's experiences, we can derive the following recommendations for German DC:

- Even for "small" budget-support donors it is important to reflect on possible links between disbursement and performance and to seek to develop a graduated system of allocation. The practice of defining generally satisfactory recipient performance as the key criterion for the disbursement of a complete tranche is not particularly well suited to correcting faulty developments in sectors in which little progress has been made.
- In order to improve the efficiency and effectiveness of aid, it would appear reasonable to concentrate on performance indicators. Generally, individual donors lack the human resources needed to assess and monitor the implementation of policy measures and their potential impacts at the user level. Clearly measurable performance-based conditionalities contribute instead to arriving at more objective disbursement decisions.
- However, the choice of performance indicators and the evaluation of goals and objectives set by recipient governments call for active participation in discussions bearing on developments in the sectors concerned. One question that needs to be clarified is whether German DC is in a position to mobilize the necessary capacities on the ground, or whether – e.g. – it might be more reasonable to adopt, to one extent or another, the indicators used by the EC. A "delegated" cooperation in the sense of a close orientation to the EC budget-support program would be recommendable above all in countries that are not priority partner countries of German DC.
- The task of providing comprehensive assessments of recipients' public financial management systems requires donors to develop expertise. German DC should thus intensify its efforts to build capacities in the field of public budgets and financial management, not least with a view to becoming involved in important thematic fields within donor groups.
- In order to effectively take part in the policy dialogue and accompany reform processes in recipient countries, it would be recommendable to strengthen German DC on the ground by developing expertise on the PRSP process, public financial management, and macroeconomic issues in recipient countries. Embassy-level DC counselors, who are responsible for coordinating German DC in recipient countries, may

well be overtaxed by this task. Together with the BMZ, the German implementing agencies should develop concepts suited to adapting their external structures to the new challenges. Together with the BMZ, the German implementing agencies should develop concepts suited to adapting their external structures to the new challenges. This goes in particular for the priority partner countries of German DC. The KfW pilot project in Kenya, which provides an expert to accompany several PRSC cofinancing operations, is a step in this direction. The BMZ should likewise step up its efforts to build and enlarge its know-how on the issue complexes referred to above and to assign responsibilities in a clear-cut fashion (e.g. as far as PGF issues are concerned).

*Conclusions regarding Germany's role as a member state in assessing the EC's budget-support programs*

As a EU member state, Germany has a voice in deciding on EC budget support approvals, prior to which it receives all financing proposals for comments. If they are to review these financing proposals on budget support in a more targeted way, staff of both the BMZ and the German implementing agencies must have sound knowledge of the EC's budget-support concept. Particular attention should be accorded to assessing the eligibility criteria that a partner country has to meet to qualify for budget support. Ultimately, this assessment has implications for bilateral German DC since it would be difficult to question a country's eligibility for budget support at the bilateral level once it had been deemed eligible for budget support at the supranational level.

In contrast to the more general eligibility decision, assessing the quality of individual program elements of the EC's budget-support financing is only possible and reasonable on the basis of specific country knowledge. In particular, the task of assessing indicators and targets requires information that goes beyond knowledge of the EC's financing proposals, and acquiring such data is often a costly and time-consuming effort. The desire to assess, and if need be to influence, the design of individual programs should therefore be weighed critically with a view to input and yield.

Unlike program approval, program implementation is not a subject addressed at EDF meetings. If member states are to have at least rudimentary knowledge of program implementation, it would make sense for them to be provided with the periodical (e.g. semiannual) disbursement data, particu-



larly with data regarding the calculation of the variable tranche. Germany should seek to ensure that the EC in fact makes this information available.

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# **Annexes**



## **Annex 1: TOR for the study: Budget Support in the EC's Development Cooperation**

### **Background**

Budget support (general budget support, sector budget support) has greatly increased in the past few years, above all within the framework of the European Development Fund (EDF), and most recently accounted for more than 20 % of the new credit commitments. In the case of the other regional programs budget support has been a tried and tested instrument in some cases (MEDA, approx. 30 %) or is still in its infancy (Asia and Latin America – also as result of the ALA ordinance that currently applies). The other programmes (TACIS, CARDS, Phare) only partially envisage the provision of budget aid. Budget support has also gained importance among other bi- and multilateral donors (Great Britain, Netherlands, World Bank etc.). As BS is a partnership based instrument for delivering resources to a country a co-ordinated effort between the donors is necessary. Accordingly, DAC launched a comprehensive evaluability study of budget support to be concluded by October 05. The main objective of the DAC evaluation is an analysis of the effectiveness of the instrument “budget support” whereas this survey (“Budget aid based on EC aid”) aims at an analysis of the performance of the donor EU in its application of budget aid. Thus, the focus of the survey is set on the examination of internal processes.

The awarding of budget support on the part of the Commission is criticised by the most varied parties, and two main arguments constantly arise:

- (a) According to them budget support was not prepared sufficiently well by the Commission, necessary inspections were not implemented in a professional manner. Consequently the support was granted although the requirements on the part of the recipients that are regarded internationally as being the standard (budgetary procedures; financial policy, financial control) had not actually been fulfilled;
- (b) The main motive for the granting of budget support is to accelerate the outflow of funds.

However, the evidence corroborating this criticism is very scanty. For example the GTZ is one of the prominent critics of the Commission's

course of action in Germany, but in all its statements to the BMZ it has attested a vote of confidence for all the Commission's budget support proposals that it has inspected. All the other, in some cases, strong criticism is frequently not based on facts.

### **Objective of the survey**

The survey has two concrete aims: First, the results of the survey should be used for the BMZ's (German Federal Ministry for Economic Cooperation and Development) dialogue with the Parliament, with the preparing organisations and the interested public. In order to do so an examination of the EDF's financing should show if the allegations to the Commission expressed above might be justified. Secondly, the results of the survey should help the BMZ to examine systematically the particular financing proposals. The implementation agencies GTZ and KfW will contribute to this examination and a monitoring-pattern will be developed. In this context it should also be examined how far the instrument budget support represents an integrative part at the planning of DC within the scope of the Country- and Regional strategies as well as in terms of the attainability of the PRS in a country.

The expert report should also serve as the basis for the BMZ, in order to active address the issue of budget support (BS) with the COM and if necessary – in cooperation with other member states (F, UK and like-minded states) if possible – to bring about the necessary changes. In this process the EDF is to the fore. The following issues should be addressed in detail in the course of the investigation:

- (a) Summary with respect to all the budget support of the COM promised up to now (as of 2000) and categorisation based on groups (general BS; sector BS etc.).
- (b) Changes (2000-2003) in the structuring of the budget support with respect to the conditions; tranches and triggers; etc.
- (c) Analysis and evaluation of the (internal) inspection regulations for the COM's budget supports (also comparison with other institutions, e.g. WB, BMZ, DFID – in particular also a comparison with the country-specific minimum requirements drafted by the BMZ, observation of the manual).

- (d) Planning of budget support within the framework of country and regional strategies as part of an instrument in order to achieve the country-specific fight against poverty objectives.
- (e) Examination of evaluations reports, if present, with respect to the COM's budget support;
- (f) Budget support and linked "Donor clubs" with respect to the coordination and complementary nature as well as a political dialogue.
- (g) Monitoring practice in the case of EU budget support (including practice when dealing with triggers).
- (h) Evaluation system on the part of the COM of individual SAFs and the tool as a whole.
- (i) The political dimension of the allocation of budget aid: The EU's DC contains an explicitly political dimension based on articles 96 and 97 of the Cotonou Agreement that envisions sanctions in the case of human rights violation, lack of democracy and legal security as well as corruption. It has to be examined in which way these criteria are applied at budget support.

The results of the expert report are of particular significance in terms of our objective of also increasingly cooperating with the COM regarding the instrument of community funding in the future against the backdrop of programme-oriented cooperation: Is COM a competent and reliable "lead partner" in the area of budget support? Up to now there has only been one reliable case (Mozambique). There is already a group of donors amongst the European bilateral donors, which closely cooperates with COM in the area of budget support and has a rotating chairmanship. The findings made here should play a significant part during the investigation.

Budget support is also an important issue for the German bilateral economic cooperation and development. The BMS stated its position in its paper "Participation in Joint Financing with Other Donors within the Framework of Programme-oriented Development Cooperation of 30.11.2001". An investigation of the "Budget support within the context of community support" would investigate additional aspects, which are also of significance for the future orientation of the tools of German state economic cooperation and development, above all set against the backdrop of the necessity of the donor procedures harmonised within the Community.



**Annex 2: Eligibility criteria for EC budget support: MEDA  
Regulation and Cotonou Agreement**

**Regulation (MEDA) No 2698/2000 (MEDA II), Annex II, Point 1. b)**

The following eligibility criteria must be met:

- the country concerned must undertake a reform programme approved by the Bretton Woods Institutions or implement programmes recognized as analogous, in coordination with those institutions, but not necessarily financially supported by them, in accordance with the scope and effectiveness of the reforms;
- account must be taken of the economic situation of the country, at the macroeconomic level, (indebtedness, cost of debt-servicing, the balance of payments, the budget situation, the monetary situation, the level of per capita income and the unemployment level) and at the level of sectoral reforms, with a view to creating a free trade area with the European Community.

**Article 61 (2) of the Cotonou Agreement:**

Direct budgetary assistance in support of macroeconomic or sectoral reforms shall be granted where:

- a) public expenditure management is sufficiently transparent, accountable and effective;
- b) well defined macroeconomic or sectoral policies established by the country itself and agreed to by its main donors are in place; and
- c) public procurement is open and transparent.

**Article 67 of the Cotonou Agreement:**

- (1) The Agreement shall provide support for macroeconomic and sectoral reforms implemented by the ACP States. In this framework, the Parties shall ensure that adjustment is economically viable and socially and politically bearable. Support shall be given in the context of a joint assessment between the Community and the ACP State concerned on the reform measures being undertaken or contemplated either at macroeconomic or sectoral level, and permit an overall evaluation of the reform efforts. Quick disbursement shall be an important feature of support programmes.
- (3) The ACP State undertaking or contemplating reform at the macroeconomic or sectoral level shall be eligible for structural adjustment assistance, giving consideration to the regional context, their effectiveness and the likely impact on the economic, social and political dimension of development and on economic social hardships being experienced.
- (4) The ACP States undertaking reform programmes that are acknowledged and supported at least by the principal multilateral donors, or that are agreed with such donors but not necessarily financially supported by them, shall be treated as having automatically satisfied the requirements for adjustment assistance.

<b>Annex 3: EC budget-support approvals, 1999–2003, and predicted approvals vor 2004–2005 (in €million), based on financing agreements</b>									
<b>Recipient country</b>	<b>Approvals</b>						<b>Forecast</b>		
	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>Total</b>	<b>2004</b>	<b>2005</b>	<b>Total</b>
Benin	0	27.0	23.4	0	55.0	105.4	0	0	0
Burkina Faso	39.2	9.8	24.2	125.0	0	198.2	0	70.0	70.0
Burundi	0	0	0	22.6	0	22.6	36.0	0	36.0
Cameroon	0	0	19.5	0	0	19.5	0	0	0
Cape Verdi Islands	0	0	0	12.1	0	12.1	5.8	0	5.8
CAR	6.5	0	26.4	0	0	32.9	0	20.0	20.0
Chad	9.2	37.1	0	0	50.0	96.3	0	0	0
Congo	0	0	0	0	106.0	106.0	0	0	0
Cote d'Ivoire	0	0	11.1	0	0	11.1	0	0	0
Djibouti	0	10.0	0	0	0	10.0	12.8	0	12.8
Ethiopia	0	0	24.4	38.3	0	62.7	95.0	0	95.0
Gabon	0	0	4.9	0	0	4.9	0	0	0
Gambia	0	9.2	4.3	0	0	13.5	0	0	0
Ghana	10.6	0	38.4	42.8	0	91.8	60.0	0	60.0
Guinea	0	0	0	11.0	0	11.0	0	35.0	35.0
Guinea Bissau	0	15.8	1.5	0	0	17.3	0	0	0
Guyana	5.4	0	0	0	0	5.4	23.3	0	23.3
Jamaica	9.0	0	21.7	0	30.0	60.7	25.0	0	25.0
Kenya	0	35.0	0	0	0	35.0	120.0	0	120.0
Lesotho	0	0	18.5	0	0	18.5	0	46.2	46.2
Madagascar	0	0	0	70.0	0	70.0	35.0	35.0	70.0
Malawi	52.1	0	0	0	0	52.1	36.0	0	36.0
Mali	37.0	0	6.0	25.8	132.9	201.7	0	0	0
Mauritania	0	0	18.1	0	0	18.1	3.6	0	3.6
Mozambique	0	13.5	57.1	168.0	16.4	255.0	0	0	0

Niger	0	24.3	3.2	20.0	90.0	137.5	0	0	0
Papua New Guinea	0	10.4	0	0	0	10.4	0	0	0
Rwanda	24.6	1.2	0	0	50.0	75.8	0	0	0
Sao Tomé and Príncipe	0	0	2.6	0	0	2.6	0	0	0
Senegal	39.1	0	5.2	0	0	44.3	53.0	0	53.0
Sierra Leone	0	20.6	0	0	0	20.6	50.0	0	50.0
Tanzania	0	0	76.1	0	114.0	190.1	0	0	0
Uganda	44.3	74.7	0	0		119.0	99.0	0	99.0
Vanuatu	0	0	0	0	0	0.0	1.7	0	1.7
Zambia	0	59.6	0	0	128.5	188.1	0	0	0
	<b>276.9</b>	<b>348.2</b>	<b>386.5</b>	<b>535.6</b>	<b>772.8</b>	<b>2320.1</b>	<b>656.3</b>	<b>206.2</b>	<b>862.4</b>
Source: Own presentation, based on EC (2004, Annex 1)									

<b>Annex 4: EDF budget-support approvals, 1999–2003 (in €million), based on financing proposals</b>						
<b>Recipient country</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>Total</b>
Benin	29.4	18.8	0	0	55.0	103.2
Burkina Faso	49.0	23.5	0	125.0	0	197.5
Burundi	0	0	0	22.6	0	22.6
Cameroon	0	19.5	0	0	0	19.5
Cape Verde Islands	15.0	0.0	12.1	0	0	27.1
CAR	6.5	26.4	0	0	117.0	149.9
Chad	9.2	37.1	0	50.0	0	96.3
Congo	0	0	0	0	105.0	105.0
Cote d'Ivoire	0	0	12.8	0	0	12.8
Djibouti	0	10.0	0	0	0	10
Ethiopia	0	0	25.7	44.0	95.0	164.7
Gabon	0	0	4.9	0	0	4.9
Gambia	0	13.5	0	0	0	13.5
Ghana	49.0	0.0	42.8	0	0	91.8
Guinea	0	0	11.0	0	0	11.0
Guinea Bissau	0	17.2	0	0	0	17.2
Guyana	5.4	0	0	0	0	5.4
Haiti	21.3	0	0	0	0	21.3
Jamaica	34.0	6.0	21.7	30.0	0	91.7
Kenya	0	35.0	0	0	0	35.0
Lesotho	0	18.5	0	0	0	18.5
Madagascar	50.0	0	0	70.0	0	120.0
Malawi	52.1	0	0	0	0	52.1
Mali	37.0	0	6.0	25.8	132.9	201.7
Mauritania	0	18.3	0	0	0	18.3
Mozambique	0	79.2	0	151.6	16.4	247.2

Niger	0	37.9	0	20.0	90.0	147.0
Papua New Guinea	0	10.4	0	0	0	10.4
Rwanda	0	59.6	0	0	55.1	114.7
Sao Tomé und Príncipe	0	2.8	0	0	0	2.8
Senegal	39.1	0	5.2	0	0	44.3
Sierra Leone	0	20.6	76.1	0	0	96.7
Solomon Islands	4.0	0	0	0	0	4.0
Tanzania	0	0	0	0	114.0	114.0
Trinidad und Tobago	0	6.0	0	0	0	6.0
Uganda	0	74.7	0	0	0	74.7
Zambia	0	109.6	0	0	0	109.6
	<b>400.9</b>	<b>644.7</b>	<b>218.3</b>	<b>539.0</b>	<b>780.4</b>	<b>2582.4</b>

Source: EDF protocols and financing proposals on budget support, 1999–2003

<b>Annex 5: EC disbursements of budget support, 1999–2003, and predicted disbursements for 2004–2005 (in €million), based on financing agreements</b>									
<b>Recipient country</b>	<b>Disbursements</b>					<b>Forecast</b>			
	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>Total</b>	<b>2004</b>	<b>2005</b>	<b>Total</b>
Benin	7.5	11.6	26.2	5.0	4.3	54.6	19.2	12.3	31.5
Burkina Faso	19.0	27.2	18.9	24.4	37.8	127.3	52.5	20.0	72.5
Burundi	0	0	0	0	8.0	8.0	36.5	10.0	46.5
Cameroon	0	10.0	0	0	8.9	18.9	9.0	0	9.0
Cape Verde Islands	0	0	0	2.0	9.0	11.0	5.5	0	5.5
CAR	6.5	0.0	11.5	0	0	18.0	12.0	10.0	22.0
Chad	0	11.1	15.8	22.4	0	49.3	38.0	8.0	46.0
Congo	0	0	0	5.0	4.6	9.6	106.0	0	106.0
Cote d'Ivoire	0	0	0	5.2	0	5.2	0	0	0
Djibouti	4.7	1.0	0	0	4.5	10.2	4.0	0	4.0
Ethiopia	0	0	0	25.8	10.7	36.5	45.0	30.0	75.0
Gabon	0	0	0	0	0	0	2.2	2.0	4.2
Gambia	0	5.0	0	0	0	5.0	4.0	0	4.0
Ghana	10.5	0	0	22.2	25.6	58.2	45.9	24.0	69.9
Guinea	0	0	0	0	0	0	10.4	10.0	20.4
Guinea Bissau	0	0	5.4	0	0	5.4	10.3	0	10.3
Guyana	2.1	0	0	0	0	2.1	6.0	8.0	14.0
Jamaica	0	2.0	17.0	6.4	0	25.4	37.0	10.0	47.0
Kenya	0	0	17.0	0	0	17.0	50.0	50.0	100.0
Lesotho	0	0	0	6.0	3.0	9.0	0	15.0	15.0
Madagascar	15.0	14.0	19.7	35.0	34.5	118.2	20.0	17.8	37.8
Malawi	20.0	0	16.0	0	0	36.0	30.5	15.0	45.5
Mali	6.6	7.4	10.4	15.0	32.9	72.3	29.6	29.3	58.9
Mauritania	10.7	0	0	5.5	5.7	21.9	4.5	3.6	8.1
Mozambique	0	57.4	65.0	30.6	41.0	194.0	50.0	42.0	92.0
Niger	0	0	13.0	16.6	24.3	53.4	35.0	35.0	70.0
Papua New Guinea	0	0	0	0	0	0	0	0	0
Rwanda	11.0	14.6	21.8	27.5	25.0	99.9	20.0	15.5	35.5
Sao Tomé and Príncipe	0	0	1.5	0	1.0	2.5	0	0	0
Senegal	2.8	0	5.2	0	3.8	11.8	35.3	15.0	50.3
Sierra Leone	0	9.7	16.6	0	0	26.3	18.4	30.0	48.4
Tanzania	35.0	0.0	25.4	37.5	68.5	166.4	31.0	38.0	69.0
Uganda	15.0	71.8	0	24.5	24.5	135.8	24.5	33.0	57.5
Vanuatu	0	0	0	0	0	0	0.7	1.0	1.7
Zambia	47.6	0	12.0	69.0	28.7	157.2	37.0	31.0	68.0
<b>Total</b>	<b>214.0</b>	<b>242.7</b>	<b>318.3</b>	<b>385.5</b>	<b>406.2</b>	<b>1566.2</b>	<b>829.9</b>	<b>515.6</b>	<b>1345.5</b>

Source: Own presentation, based on EC (2004, Annex 1)

<b>Annex 6: Calculation of a variable tranche: the example of Ethiopia</b>							
	Target	Result	Source	Re- marks	Score by Delega- tion	Score by MO- FED	Sug- gested disburse- ment in Mio. Euro
<b>Health</b>							
Under 5 DTP3 vaccination cover	From 42 % to 45 %	51.5 %	MOH	Data collect- ed per ultimo July 2002	1	1	
Health centers + posts util. rate	From 27 % to 29 %	23 %	JRM 03	Idem above	0	0	
Ante-natal care coverage	From 34 % to 38 %	34.1 %	MOH		0	0	
<b>Education</b>							
Primary girls enrolment rate	From 40.7% to 47%	51.2%	JRM 03		1	1	
Grade 1 drop- out rate	From 27.9 % to 24 %	27.5 %	JRM 03		0	0	
Share of qualified teachers	From 23.9 % to 45 %	33.1 %	MOE		0.5	0.5	
<b>Roads</b>							
Share of roads in acceptable condition	From 57 % to 61 %	60 %	RSDPII (03- 2003)	March 2003: 62 %	1	1	
Road Network Density (Index A)	From 27.7 % to 28.5 %	28.6 %	RSDPII (03- 2003)		1	1	
<b>Subtotal</b>					<b>4.5 (56 %)</b>	<b>4.5 (56 %)</b>	<b>4.5 (of 8)</b>
<b>PFM</b>							
Federal/Reg. Budget conso- lidated	Federal level + 1 region	Final not yet ready	MO- FED		0.5	0.5	

Budget Support in the EC's Development Cooperation

Food security included in budget	FS Budget line + FA Annex	FS Budget line: yes; FA Annex: no	MO-FED		0.5	0.5	
3 years rolling MEFF/PEP	Approved by Council	MEFF has been prepared; not PEP	MO-FED		0.5	0.5	
Backlog of accounts reduced	Regions 1 year backlog	Backlog has been reduced	MO-FED		1	1	
Accountants/Internal auditors trained	From 4.600 to 6.000	5.891	MO-FED	200 to be trained in second quarter 2003	1	1	
Parliament members trained	Training started	400 MP have been trained	MO-FED		1	1	
<b>Sub-total</b>					<b>4.5 (75 %)</b>	<b>4.5 (75 %)</b>	<b>4.5 (of 6)</b>
<b>PSD</b>							
Land titles to S/M businesses	2001/02 increase by 15 %	Land has been allocated. % to S/M unknown	MOTI		0.5	1	
New/restructures laws and policies	Five in 2002	9	MOTI		1	1	



New/revised regulations/procedures	Eight in 2002	2	MOTI		0.5	1	
<b>1. SUB-TOTAL</b>					<b>2 (66 %)</b>	<b>3 (100 %)</b>	<b>1.65 (of 2.5)</b>
<b>2. TOTAL</b>					<b>11</b>	<b>12</b>	<b>10.65 (of 16.5)</b>
*Based on the Delegation's assessment							

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