Ministry of Foreign Affairs of the Netherlands

IOB Evaluation

Budget support: Conditional Results

Review of an instrument (2000-2011)

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Foreword

From the late 1990s onwards, various donors provided development assistance in the form of direct support to recipient countries' budgets. The idea was that this would produce a more harmonised form of assistance, dovetail better with partner countries' priorities and thus promote ownership as well. It would lead to more efficient and more effective aid with more sustainable results. It was also thought that the instrument could be used to create a dialogue that would help achieve sorely needed reforms.

Unlike previous forms of macro-support, such as balance of payments support and import support, budget support did not focus so much on macro-economic stability but more on helping to implement national anti-poverty strategies and achieving the Millennium Development Goals. Another difference with older forms of macro-support is that donors would not provide support on the condition that partner countries would start implementing a number of reforms, but that the latter would only be eligible for support after it was clear that they had a stable macro-economic and socio-economic policy and the capacity to effectively implement an anti-poverty programme.

The Netherlands was one of the first countries to provide general budget support and encourage the harmonisation of aid among donors. Between 2000 and 2011, 23 countries received a total of €1.75 billion in budget support. This is approximately 3.4% of the Netherlands' overall assistance in this period. Burkina Faso, Ghana, Mali, Mozambique, Tanzania and Uganda were the most important recipients financially speaking. Global expenditure on budget support increased from US$1.9 billion in 2002 to US$5.3 billion in 2009. Nevertheless, with an average of about six euros per inhabitant per year, total amounts were relatively modest for most recipient countries.

Over the years, expectations have made way for critical views. Budget support, it was said, was a 'blank cheque' that could disappear into the pockets of officials in corrupt regimes. To boot, the instrument was more likely to undermine than reinforce the desired socio-economic and political development. Sometime around 2008, a number corruption cases, human rights violations, election fraud and restrictions of political freedom came to light in several partner countries. In response, the Netherlands suspended budget support to these countries. Uncertainty about its effectiveness also contributed to the instrument being curtailed in the 2010 coalition agreement.

With this as a backdrop, IOB has conducted a review of more than 10 years of budget support. The evaluators examined both the development and implementation of the Dutch policy, and the international development of the policy theory and the achievements in the area of macro-economic development, good governance, poverty reduction and public services. The review relies on findings in theoretical and empirical literature, as well as on IOB's own research. Six country cases (Ghana, Mali, Nicaragua, Tanzania, Vietnam and Zambia) were part of the study. IOB conducted extensive evaluations of budget support in two of these countries in 2010 and 2011 (Nicaragua and Zambia), the latter together with Germany and Sweden.

IOB evaluators Geske Dijkstra and Antonie de Kemp conducted the policy review, with the support of research assistant Denise Bergkamp. The review was supervised by Henri Jorritsma, acting director of IOB. Evaluators Phil Compernolle and Nico van Niekerk provided commentary on the first draft.

A special word of thanks goes to the expert peer group, consisting of Henri Jorritsma (chairman), Dr Nadia Molenaers (University of Antwerp), Prof. Dr Jan Willem Gunning (VU University Amsterdam), Arend-Jan Boekestijn (Utrecht University), Jan Rinzema (DEC, Ministry of Foreign Affairs) and Bengt van Loosdrecht (DAF, Ministry of Foreign Affairs), who provided the last draft with extensive and extremely valuable commentary.

A word of thanks also goes out to the employees of DEC's management and the involved embassies who helped IOB to collect material for this review and provided commentary on drafts.

A word of thanks also goes out to the employees of the Effectiveness and Coherence Department (DEC) and the involved embassies who helped IOB to collect material for this review and provided commentary on drafts.

IOB assumes final responsibility for this report.

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Abbreviations

ACP	African, Caribbean and Pacific Countries (ACP countries)
AfDB	African Development Bank
BS	Budget support
CFAA	Country Financial Accountability Assessment
CPIA	Country Policy and Institutional Assessment
CRS	Creditor Reporting System
DAC	Development Assistance Committee
DFID	Department for International Development
DHS	Demographic and Health Survey
EC	European Commission
ECOMOG	Economic Community of West African States Monitoring Group
EDF	European Development Fund
EU	European Union
GBS	General budget support
GC	General Consultation
GDP	Gross domestic product
GHP	Good governance, human rights and peace-building
GNP	Gross National Product
HDI	Human Development Index
HIPC	Heavily Indebted Poor Countries
IDD	International Development Department
IMF	International Monetary Fund
IEG	Independent Evaluation Group (WB)
IEO	Independent Evaluation Office (IMF)
IOB	Policy and Operations Evaluation Department of the Netherlands Ministry of Foreign Affairs
IOV	Predecessor of IOB (see above) established in 1977
MDG	Millennium Development Goal
MDRI	Multilateral Debt Relief Initiative
MYSP	Multi-Year Strategic Plan
MoU	Memorandum of Understanding
MTEF	Medium-Term Expenditure Framework
NAO	National Audit Office
NGO	Non-Governmental Organisation
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PAF	Performance Assessment Framework
PAM	Performance Assessment Matrix
PER	Public Expenditure Review
PFM	Public Financial Management
PRSC	Poverty Reduction Support Credits
PRSP	Poverty Reduction Strategy Paper
RPE	Ministerial decree on performance measurement and evaluation

SIDA	Swedish International Development Cooperation Agency
SMART	Specific, measurable, attainable, relevant and time-bound (related to progress indicators)
SPA	Strategic Partnership with Africa
SWAp	Sector-Wide Approach
TK	Dutch House of Representatives
UEMOA	Economic Community of West African States
UN	United Nations
UP	Underlying Principles
WB	World Bank
WDI	World Development Indicators
WRR	Dutch Scientific Council for Government Policy

Summary and conclusions

In the late 1990s, donors increasingly started to support the budgets of governments in developing countries directly. The main thought behind this was that this *general budget support* would contribute to more harmonised aid and to more alignment with the priorities of partner countries and therefore also promote ownership. That would lead to more efficient and more effective aid with sustainable results.

Although the instrument as we know it today mainly took shape at the turn of the century, macro-support is not new. The most important forms of aid in earlier decades were import support, balance of payments support and, a little later, debt relief. In the longer term, however, donors did not give more disposable resources to developing countries than in previous years. Between 1986 and 1993, in the heyday of structural adjustment programmes, programme aid accounted for about 10% of total aid in the world, whereas between 2000 and 2010 that number was between 3% and 4%. Programme aid was a larger percentage of total aid for individual recipient countries, however.

There are differences as well. The primary aim of programme aid used to be macro-economic stability, and so the conditions and policy dialogue were also geared to this aim. Budget support has different aims in mind, namely to help carry out national poverty reduction strategies and to achieve the Millennium Development Goals. A secondary aim (or condition) is to improve financial management. Offsetting fiduciary risks in this way is a major priority for donors. In addition, good financial management is both a condition for effective budget management and for improving democratic control on the use of resources. Budget support would also replace strict conditionality with partnership. The policy dialogue, which was mainly conducted by the IMF and the World Bank under previous forms of programme aid, took on a broader structure and dealt with a more varied range of topics. Major annual reviews with extensive performance agreements were an expression of this.

The Netherlands was a trendsetter when it comes to the provision of general budget support. The instrument gradually began to take shape from 2000 onwards, initially mainly on a one year basis. Its structural use began to increase from 2002 onwards, in line with international developments. This changed in 2007, after a period of growth that lasted five years. The political climate in the Netherlands changed, partly influenced by reports in the media. A number of serious irregularities came to light in several recipient countries, one shortly after the other, involving human rights violations, election fraud and restrictions of political freedom. The Dutch minister responsible for the aid portfolio consequently suspended budget support to these countries in order to send a political signal, both to the partner countries and to the Netherlands. Internationally, doubts about the effectiveness of the instrument began to grow as well. Budget support, it was said, 'was disappearing into the pockets of officials in corrupt regimes' and it was undermining rather than reinforcing desired socio-economic and political development. The Dutch House of Representatives became increasingly critical as well. The cabinet enforced stricter entry conditions and ended, partly as a result of budget cuts, this type of support to most countries.

Between 2000 and 2011, the Netherlands spent €1.75 billion on general budget support. This amount corresponds to approximately 3.4% of the total ODA in this period. A total of 23 countries received aid in this form. Most aid went to Burkina Faso, Ghana, Mali, Mozambique, Tanzania and Uganda.

The aim of the policy review is, first, to assess the functioning of the budget support instrument in practice and the results that donors have achieved worldwide, and, second, to evaluate how the Netherlands has used this instrument in the past decade.

The review used several methods. First, IOB conducted an extensive study of international academic and non-academic literature, including reports, evaluations and policy documents. Second, the team conducted a desk study on six countries to examine in detail how the instrument has been used and what it has achieved. The six case study countries – Ghana, Mali, Nicaragua, Tanzania, Vietnam and Zambia – all received relatively sizeable amounts of budget support from the Netherlands. Moreover, IOB attempted to create a variety in its selection regarding the relative importance of the modality for recipients' budgets, in the extent of agreement between recipients and donors in terms of preferences, and in regional distribution. And third, the team conducted quantitative international research, focusing in particular on the international scope, the application of entry conditions and the achievements of budget support.

Conclusions

1 **Budget support has helped to improve access to education and health care. Poorer and more rural communities often benefited from this support. It had a limited impact, however, on increasing the incomes of the poorest groups.**

Available literature suggests that budget support has a (limited) positive effect on economic development. Although research on the relationship between aid and economic growth faces serious methodological challenges, the most rigorous studies show a positive, long-term effect. The latter is also true of general budget support.

It is difficult to determine exactly the impact of budget support on poverty reduction. Poverty rates are falling in many developing countries, albeit gradually. Countries that received budget support achieved slightly better results in the area of reducing income poverty. The growth elasticity of poverty in countries that received budget support was also slightly higher on average than in countries that did not receive such support. However, it is difficult to attribute these improvements to this modality. Much also depends on the policies pursued in those countries. Donors have limited influence on these policies, and budget support has not changed that.

The level of support was also too low for a substantial reduction of poverty. The most important recipient countries, who had an average poverty rate of 50%, received an average of less than six euros per inhabitant per year. These countries also used support primarily for expenditures that would only help reduce poverty in the long term.

Donors often had unrealistic expectations about the possibility of increasing the incomes of the poorest communities in the short term. They rarely asked themselves which results could be achieved with which resources and within which time span, and they often expected too much from automatic 'trickle down' effects of economic growth. In the dialogue with recipients, they emphasized the necessity of increased expenditure in the social sectors, but this does not have an impact on incomes in the short-term.

General budget support did help public service expenditures to increase, especially in education and health care. Expenditures in these sectors increased more in countries that received budget support than in comparable countries who could not benefit much or at all from it. Moreover, there was a leverage effect in various countries: the increase in expenditure was greater than the financial transfers alone. The additional resources were used for both investments and the running expenses, including salaries in the education and health-care sectors. The quality of the services, however, remained a serious concern.

Evaluations show that the additional resources led to an increase of public services and their use. Various studies also show that the poorest groups in particular benefitted from them. Countries with substantial budget support made more progress on several MDG indicators than comparable countries with little or no budget support. They climbed more *on average* on the UN development index than countries with little or no budget support, even after controlling for economic growth, good governance and debt relief.

2 **The policy theory behind general budget support has changed over time: initially, countries had to comply with strict entry conditions in the area of socio-economic policy. Soon after, donors added improved governance as a condition as well. Good governance became a second objective after poverty reduction. In light of previous experiences, this was not a highly realistic objective, and it moreover potentially undermined the effectiveness of the fight against poverty.**

More often than not, countries that received budget support did not meet the entry conditions for good socio-economic policy and good institutional capacity. Quantitative analyses conducted by IOB show that good governance, as measured by the Kaufmann indicators, was not a condition at all: countries with higher scores did not have a better chance of receiving budget support. The case studies and the analysis of Dutch policy revealed that countries essentially had to show they *intended* to improve their governance practices and financial management.

Since entry conditions were not always met, there was no longer any guarantee that ownership would be respected. Whereas the original policy theory mainly emphasised budget support as a financing instrument, the emphasis increasingly shifted onto the policy dialogue. The resources therefore not only functioned as a 'financial incentive' but also as a means of 'buying your way in'. At the same time, the donors' focus increasingly shifted from promoting good policy to promoting good governance. The policy dialogue became a political dialogue. As a result, budget support was given a dual objective: both poverty reduction and improved governance. But previous research had already shown that attempts by donors to change the administrative and political system were largely ineffective. Moreover, the great deal of attention being paid to the second objective weakened budget support's capacity to fight poverty. Experience shows that these two objectives are sometimes incompatible.

3 Dutch policy making has increasingly focused on improving governance as a goal, using policy dialogue and political dialogue as main instruments to achieve this goal, without any critical reflection on the possibility of actually having influence.

The shifts from having good governance as an entry condition to a goal, from fighting poverty to promoting good governance and from a financing instrument to policy dialogue and political dialogue as the main instrument are clearly visible in Dutch policy making and policy implementation. The Netherlands increasingly focused on instruments and objectives upon which budget support had little impact, with disregard for achievements in social areas. The minister had emphasised on several occasions that budget support could not buy reforms, and yet that is clearly what Dutch policy aimed to do. It is telling that budget support was never terminated because the minister had doubts about recipient governments' dedication to their poverty reduction policies, but because these countries achieved poor results in the area of good governance. This involved both political problems and cases of corruption.

4 In practice, budget support entailed substantial transaction costs. These costs were lower, however, than with project aid.

In practice, budget support went hand in hand with an intensive policy dialogue and political dialogue, extensive donor interference in government policy and detailed monitoring conditions. Since the policy dialogue now covered yet more issues and was being conducted by yet more donors, transaction costs were higher than with previous, different forms of programme aid, such as balance of payments support and debt relief. The costs were lower per euro of aid than with project aid, both for donors and for recipients. Since project aid remained an important instrument in addition to budget support, however, on balance the transaction costs remained high.

5 **The predictability of budget support initially left quite a lot to be desired. This made it more difficult to use budget support resources for additional expenses. In the course of the decade, the use of the instrument for this purpose improved.**

The *predictability* of budget support varied considerably from country to country and from period to period, but particularly in the beginning it was not always better than with project aid. A great deal of budget support was transferred at the end of the year, which sometimes led to expensive domestic loans to bridge the period until disbursements were made. Both factors contributed to the fact that recipient countries did not use part of their budget support for additional expenses, but rather to increase foreign reserves or repay domestic debt. Although this was not the point of budget support, it could be seen in a positive light: it gave countries a better chance of having a stable macro-economy in the future. That is in itself essential for economic growth and poverty reduction. In addition, they could allocate the resources in a subsequent year. There were also delays, incidentally, because recipient countries did not always meet their conditions or submit their disbursement requests on time. In African countries, predictability and being on time vastly improved over time. Partly as a result of this, approximately 60% of the budget support resources between 2002 and 2010 were used to directly increase government expenditures.

6 **The budget support policy dialogue was unable to produce (political) reform or alter the priorities of the socio-economic policy, but it was effective in improving financial management and financial transparency.**

Donors wanted to exert influence on government policy in essentially all areas, which resulted in a series of extensive and detailed process and performance indicators involving all areas of government policy and government institutions. Priorities were not always clear. Moreover, the indicators used were not always relevant nor could they be reliably measured or manipulated in the short term by the government. Despite this massive effort, the goal of improving policy – and increasingly (good) governance – in recipient countries was only marginally achieved.

Donors did not succeed in fundamentally changing government priorities, nor were they able to improve governance in areas like increasing the independence of the judiciary, promoting involvement of civil society or end clientelism in the public sector. In these areas, changes were implemented either with delay or not at all, or they were purely cosmetic or formally implemented without anything substantial changing at all. Suspending budget support in response to corruption, the violation of human rights or elections that were not completely fair has rarely led to change as the donors would like to see it. The fact that donors did not always act in harmony in such cases did not help either.

The direct contribution to general resources gave donors an argument for putting improved financial management on the agenda. They could only provide budget support if the fiduciary risks were adequately offset. Technical assistance was frequently used for this purpose. Although it often took a long time for changes to be implemented, budget

support in these areas was effective because reforms were not in conflict with the interests of the political elite.

At the same time, there is no reason to conclude that governance worsened under budget support's influence. An international comparative analysis shows that a positive correlation exists between the amount of budget support received and an *improvement* of the Kaufmann indicators for good governance, while there was no link between budget support and the quality of governance at the beginning of the period.

7 There is no evidence that budget support has reduced tax revenue. Nor is there evidence that it has had a positive effect on tax revenue.

Budget support has not led to reduced tax revenue. In the six case study countries, it increased, also as a percentage of GDP. One of the explanations for this is that by providing budget support, donors also had a motive for interfering with tax collection. They often gave technical assistance, which led to more effective tax collection. Econometric calculations do not now show budget support as having a significant effect, either in a positive or a negative sense. Evaluations of individual countries often reach the same conclusion.

8 Budget support can be an effective instrument if the donor and recipient agree on the main policy and expenditure priorities. The degree to which a recipient country meets the prevalent criteria of good governance is neither a necessary condition nor a sufficient condition for the effectiveness of general budget support.

The effectiveness of the instrument in achieving several of the Millennium Development Goals, especially in education and health care, can be explained by the agreement in preferences between donors and recipients of budget support in these areas. As far as improvements in financial management are concerned, here too recipient governments had a vested interest. But it is not possible to use budget support to enforce reforms. Financial incentives do not work for issues that are not backed by the political elite. Threatening to suspend aid is equally ineffective.

Empirical studies also show that the relationship between good governance and poverty reduction is not entirely unambiguous. Various countries that scored low on the good governance indicators had strong economic growth and reduced poverty (e.g. Vietnam and Rwanda). Conversely, there were countries that were better at meeting Western demands of good governance, but whose governments showed little interest in actively fighting poverty (e.g. Nicaragua). The policy dialogue barely had an impact on the anti-poverty *policy*, but the financial support was effective in Vietnam though not in Nicaragua.

These conclusions do not alter the fact that there can be good political grounds *not* to allocate budget support to a country, even if the instrument would presumably be effective in the given situation.

9 **It is important to make a clear distinction between general budget support and stability support to post-conflict states. The latter has different goals, and different entry conditions than general budget support.**

In the dialogue with the Dutch House of Representatives, the minister mentioned Burundi as one of the countries receiving budget support from the Netherlands. The ministry insufficiently discerned between regular budget support and macro-support to fragile states such as Burundi. This had negative repercussions on support to Burundi, as well as on the appreciation for the instrument of budget support. The House, critical of human rights violations in this country, evaluated macro-support to Burundi by the standards of budget support and, conversely, used the case of Burundi to (negatively) evaluate the instrument of budget support.

Programme aid (macro-support) to fragile states such as Burundi, however, has a goal that differs from the objectives of budget support. General budget support aims to support a partner country's poverty reduction policy and assumes that the partner country fulfils the requirements to implement effective policy in this area. Stability support does not assume this. Rather it aims to *create* economic stability and help finance running expenses in order to prevent that what is – at that moment – a fragile state deteriorates any further. This kind of support has a different set of requirements, including much closer supervision by the IMF and the World Bank. Experiences with stability support in the 1990s (to Uganda in the late 1980s and early 1990s, and to Mozambique in the early 1990s, just after their civil wars) teach us that this support was effective in promoting macro-economic stability.

1

Introduction

1.1 Background

In its effort to enhance the effectiveness of aid, the Netherlands has searched for new instruments on several occasions. General budget support is one of these. At the end of the 1990s and more or less in tandem with the introduction of the sector approach, the Dutch Minister for Development Cooperation took action to directly support the budget of a number of partner countries. Together with a few like-minded countries, the Netherlands was initially at the forefront of this effort to harmonise bilateral aid and enable it to dovetail better with policy in partner countries, thereby also creating more 'ownership'. In 2000, the Millennium Development Goals (MDGs) contributed to the growth of this instrument because, so it was thought, they would be easier to achieve through national prioritisation and implementation.

The instrument also brought with it new challenges. It was more difficult to show results than with other forms of aid. Moreover, there was increasing uncertainty about whether recipient countries were still fulfilling the conditions for budget support – not only uncertainty about their institutional capacity, but also whether they had the political will to carry out the necessary reforms. After several scandals, the question was raised whether these countries were sufficiently prepared to tackle corruption. Various authors, including Dambisa Moyo from Zambia, suggested that development cooperation, and budget support in particular, perpetuated corruption and existing political relations, thereby impeding the development of these countries.

Concerns gradually won ground. The Dutch House of Representatives used the IOB evaluation on the Netherlands' Africa policy (2008) to launch an extensive discussion about the instrument. Controversy about the budget support to several countries (such as Uganda, Nicaragua, Rwanda and Burundi) was the immediate cause for this discussion. In 2010, the new conservative government wanted to apply the instrument more selectively. The Coalition Agreement stipulated that budget support would not be provided when there is evidence of corruption or human rights violations, or insufficient evidence of good governance. As a result, in 2012 only a few countries still received general budget support.[1]

This report gives an account of a policy review of the general budget support that the Netherlands provided between 2000 and 2011. The questions it asks are about both policy development and the instrument's effectiveness. This report uses previous IOB evaluations, as well as findings from other studies.

[1] Dutch budget support to one of these, Mali, has been suspended as a result of the military coup in that country.

1.2 Objective and research questions

The objective of this policy review is, in the first place, to evaluate how the Netherlands implemented this aid modality in the past ten years. In addition, IOB intends to shed more light on the results in order to make a constructive contribution to the debate about a contested instrument.

The following questions, which were taken from the ministerial decree on performance measurement and evaluation ('Regeling Prestatiegegevens en Evaluatieonderzoek', or RPE), acted as the guideline for the policy review:

Description and analysis of the problem:

1 What were the arguments in the international debate for providing budget support?

Description and justification for the Dutch Ministry of Foreign Affairs' role:

2 What were the arguments for the Minister for Development Cooperation and the Minister of Foreign Affairs to provide budget support?

3 What were the expected results?

Description of the policy implementation:

4 How much has the Netherlands spent on budget support from 2000 until 2011?

5 Which countries received general budget support? Based on what criteria? Were these criteria consistently applied?

6 How did the ministry monitor policy implementation and progress regarding expected results?

Results:

7 What information exists about the results of budget support provided by the Netherlands?

8 What information exists, more generally, about budget support's impact on:
   a policy and governance in partner countries; and
   b economic growth and poverty reduction?

1.3 Approach

Measuring the impact of budget support

Much more so than with project aid, it is difficult to determine how much general budget support has contributed to the realisation of the objectives. The 'Dutch euro' is impossible to monitor anymore, nor is it easy to gauge how much influence the Netherlands, or even all the donors, have had on partner countries' policies. These factors have contributed to making this a much contested instrument.

The policy theory contributed to this as well (see also chapter 2). Budget support's expected impact was often formulated in comparative terms – more effective, more efficient, more sustainable – without further elaborating on this. That makes it difficult to evaluate the results of budget support.

There are two clearly distinct evaluation methods for approaching an evaluation of budget support's impact:

1 individual case studies of countries that receive budget support. These evaluations are generally *qualitative* in nature; and
2 international comparative econometric research. This research, which attempts to explain differences between countries is primarily *quantitative* in nature.

There is a variant to the first approach in which individual case studies are part of a larger evaluation. The objective then is to produce more generalised statements based on separate case studies. The most well-known example is the *Joint Evaluation of General Budget Support* from 2006 (ODI and Associates). One bottleneck, however, is the lack of a 'counterfactual', or alternative situation, which makes it difficult to attribute observed results to the instrument of general budget support. Furthermore, many of these evaluations focus primarily on the policy dialogue and immediate changes in policy, but much less so on the ultimate results.[2]

The second approach explicitly incorporates a counterfactual and is therefore theoretically better equipped to address attribution problems. After all, if budget support is indeed more effective at promoting economic growth, then this should be tangible in terms of results: countries that have received substantial budget support should, *all things being equal*, have more growth than *comparable* countries without budget support. The problem, of course, is with the words, 'all things being equal' and 'comparable'. There are many methodological problems with international comparative research, and they have resulted in heated discussions in the academic literature. On the other hand, however, it is precisely the transparency of this approach that has made the discussion possible in the first place. This, conversely, contributed to an improved methodology with more robust results.

IOB has chosen to combine these two approaches in this policy review. The *qualitative* approaches attempt to explain why budget support did or did not work in specific circumstances. The *quantitative* approaches test hypotheses that have emerged from these case studies in order to arrive at more generally valid statements. The review does not rely on the evidence of the individual approaches, but rather combines them to get more robust results. The team also conducted as much supplementary empirical research as possible. The objective was to create as complete a picture as possible of the results of general budget support.

The researchers have used different techniques to address attribution problems. Regression techniques made it possible to check for the impact of other potential variables, such as economic growth or good economic policy. IOB has solved the problem of unobservable variables that may lead to biased estimates with *difference-in-difference* and *fixed effects* regressions. To address the problem of *reverse causality* of aid (aid does not only have an impact on development, but countries also get help because of a lack of economic

[2] Some evaluations of general budget support do incorporate a counterfactual in some areas of government policy, and are thus able to determine the impact of government interventions. These evaluations assess the effectiveness of government policy, to which budget support has contributed.

growth), the team instrumented for budget support where possible. See Annex V for further explanation.

Data

The review made extensive use of international academic and non-academic literature, including reports, evaluations and policy documents. For the quantitative research, the team relied on data from the OECD/DAC CRS database, IMF, the World Economic Outlook and World Bank World Development Indicators.[3]

There are various indicators that assess elements of a partner country's policy and governance, and of its democratic values (see chapter 2 as well for a more detailed explanation). The Country Policy and Institutional Assessment (CPIA), which the World Bank uses to allocate aid to developing countries, is a well-known and frequently used example. It combines assessments about policy *and* governance. The policy indicators incorporate the neoliberal ideology; the governance indicators are more technical in nature and include issues such as financial management, effectiveness and transparency, rule of law and respect for property, and regulatory quality. The *Kaufmann indicators* are older and cover different dimensions of politics and governance: political stability, freedom of expression and democratic accountability, regulatory quality, rule of law, control of corruption and government effectiveness. Just like the CPIA, the scores are based on perceptions.[4] *Freedom House* focuses on a state's democratic values.[5] There are corruption indices as well, such as *Transparency International*, and indices by the World Bank that measure the business climate (Doing Business).

IOB mainly used the Kaufmann indicators for the analyses. There were several reasons for this choice:

1 First, the availability of the data. The Kaufmann indicators are available for more years than the CPIA scores and the Freedom House indicators;
2 The breadth. The Freedom House indicators, for example, cover limited ground. The CPIA indicators mainly cover the technocratic elements of good governance, such as financial management, protection of property and regulatory quality. The Kaufmann indicators are broader (see also section 2.4).

Incidentally, the choice of indicators makes little difference in terms of the conclusions, as we show in some of the analyses. That is because of the high correlation between the indicators (for example, the correlation between Kaufmann and CPIA indicators is 0.74). This correlation is not surprising, because most indicators express the quality of a government's policy and governance practices.

3 IOB has supplemented the OECD/DAC data, which does not contain the World Bank's budget support, with data from the evaluation published by PRSCs in 2010 (IEG, 2010).
4 See http://info.worldbank.org/governance/wgi/index.asp.
5 Freedom House is an organisation that monitors democratic freedom and compliance with human rights and supports change. The organisation monitors democratic developments in countries on an annual basis.

The correlation between the separate Kaufmann indicators does not make it possible or useful to incorporate them all individually in the regression analyses. The high correlations between the indicators mean that the coefficients of individual indicators are difficult to determine. For this reason, we have taken the scores from the six Kaufman dimensions and compiled them into one single factor score (using principal components analysis). This factor score can be viewed as a *latent* (not directly measurable) variable, the six dimensions of which are measurable indicators.[6] The six dimensions correlate with the factor score as follows:

- Political stability (r=0.76);
- Freedom of expression and democratic accountability (r=0.78);
- Regulatory quality (r=0.87);
- Rule of law (r=0.95);
- Control of corruption (r=0.92);
- Government effectiveness (r=0.92).

Six case studies

For the research on the objectives, justifications, use of the instrument by the Netherlands and results of budget support, the team also conducted six country case studies. IOB set up and analysed these by means of a uniform system. The objective of the case studies is to show, in a consistent manner based on six experiences, how general budget support was applied in practice. The six countries were important to Dutch policy. The case studies are based on existing empirical data. IOB did not conduct any new fieldwork.

An initial selection of eleven countries took place based on the following criteria: 1) the amount of budget support they had received from the Netherlands, and 2) their importance in the public debate in the Netherlands. IOB subsequently selected six countries from this group for closer study. The first two countries to drop out were important in the debate, but were also countries that received hardly any or no general budget support from the Netherlands. These countries, Burundi and Rwanda, will be discussed in chapter three.

For the further selection, the team attempted to introduce as much variety as possible regarding circumstances that could have an impact on 1) the implementation of general budget support (GBS) (for example, the degree to which donors attempted to influence policy and governance), and 2) the ultimate results of GBS.

IOB expected two variables to have a particular impact on the implementation and results of GBS: the degree to which there was agreement between donors and recipients on preferences, and financial variables, especially the part GBS played in recipients' government budgets. The more agreement exists, the less need there will be for policy or governance conditions, and the more one can expect from the results of GBS. The bigger the part GBS plays in the budget, the more influence donors may have, and this could potentially (if the right policy conditions have been set) also produce better results for GBS.

[6] The factor scores are calculated across the entire database over the period 1998–2010 for a total of 155 countries. The mean score is 0 with a standard deviation of 1.

For the first variable, IOB used the six Kaufman indicators for good governance, namely voice and accountability, political stability, government effectiveness, regulatory quality, rule of law and control of corruption. What is also important for agreement on preferences is whether the country has an IMF agreement and an approved PRSP. All eleven countries had an approved PRSP, and only Vietnam had no IMF agreement. Vietnam also scored poorly on 'good governance'. This means that using an IMF agreement as an indicator had little added value. For the good governance indicator, averages were used from the period 2004–2010. For the second variable, IOB looked at the relationship between total GBS and government expenditures (averages for 2004–2010).

In addition to these two variables, IOB also took into account regional distribution, and included pragmatic (recent evaluations) and political considerations (in other words, political interest in the countries) in the analysis.

Based on these starting points, IOB selected the following six countries: Ghana, Mali, Nicaragua, Tanzania, Vietnam and Zambia. Table 1.1 contains these countries' scores in the two variables (based on data from the period 2004–2010). This choice also reflects good regional distribution. In addition to four African countries, an Asian and a Latin American country are also included in the analysis. Moreover, at least one budget support evaluation was available for each of these countries.

Table 1.1: Classification of the six countries by governance and financial scope of GBS

Governance	ABS/Government budget		
	High	Average	Low
Good		Ghana	
Average	Tanzania	Mali	Vietnam
Bad		Zambia	Nicaragua

Annex I contains a more detailed explanation of the choice of countries.

1.4 Reading guide

The study begins with an analysis of the international justification for and objectives of budget support and the intervention logic that was used. Chapter 3 describes and analyses Dutch policy on budget support. Chapters 4–7 provide the results of budget support. Chapter 4 discusses the intermediate results of budget support, such as predictability, the impact on transaction costs and the macro-economic use of the resources. Chapter 5 analyses the ways in which donors have attempted to influence policy and governance, and the effect of these attempts. Chapter 6 discusses the impact of economic growth, and chapter 7 subsequently deals with the impact of poverty and access to and the use of social services. These four chapters all have approximately the same structure: they discuss for each subject the available literature, the results of the six case studies and the results of quantitative comparative research.

2

International justifications and objectives for budget support

2.1 What is budget support?

Budget support is a form of programme aid or, as it is often referred to in the Dutch policy context, macro-support. Programme aid is not linked to specific projects, but in practice it has frequently been tied to policy conditions. In 1991, OECD defined programme aid as follows: 'Programme assistance consists of all contributions made available to a recipient country for general development purposes, i.e. balance of payments support, general budget support and commodity assistance, not linked to specific project activities' (OECD 1991).

In the 1980s, balance of payments support and import support were the most common forms of programme aid. In the 1990s, debt relief was added to the list, and from about 2000 onwards, budget support became the dominant modality. Budget support involves 'a method of financing a partner country's budget through a transfer of resources from an external financing agency to the partner government's national treasury. The funds thus transferred are managed in accordance with the recipient's budgetary procedures' (OECD 2006: 26). A distinction can be made in budget support between general budget support and sector budget support. In both cases, the central government receives the resources, but in sector budget support, the policy dialogue focuses on a specific sector, while in general budget support, the policy dialogue may focus on the overall government policy (OECD 2006). Both forms of aid belong to the family of 'programme-based approaches', as defined in the Paris Declaration on Aid Effectiveness (High Level Forum 2005). But the programme-based support category includes other aid modalities as well, if provided in the context of a plan set up by a recipient country. This is true, for example, for the sector approach, or Sector-Wide Approach (SWAp), which can include both sector budget support and 'basket funding' and project aid.

2.2 Why budget support?

It was in about the year 2000 that budget support was generally viewed as the best aid modality. Budget support offered a response to the dissatisfaction with two other forms of aid, namely balance of payments support, on the one hand, and project aid, on the other hand.

There were, to begin with, a number of practical reasons for the declining popularity of balance of payments support and debt relief. First, most developing countries did not have regulated exchange rates any more in the 1990s, as a result of which there was no visible scarcity of foreign exchange any more. Second, the enhanced Initiative for the Heavily Indebted Poor Countries, which was implemented in 1999, largely made (further) debt relief

superfluous.[7] Third, a focus on the Millennium Development Goals, especially in the areas of education and health care, highlighted the lack of governmental financial resources to achieve these goals. Macro-support, or programme aid, would therefore be provided in the form of budget support from that point on.

But there was also more fundamental criticism of past programme aid. This concerned the conditions that it set. Much research in the late 1990s revealed that setting policy conditions was ineffective. Countries only carried out what they originally intended to carry out in the first place. If countries did not want to, they often merely carried out policy conditions cosmetically or temporarily (Collier et al. 1997, Dollar and Svensson 2000, Dijkstra 2002, Killick et al. 1998). This led to calls for greater selectivity. 'Buying' reforms by formulating policy ex ante had failed. So donors would have to determine ex post whether countries had carried out effective policies, and make resources available based on that assessment. This would also lead to more 'ownership' in recipient countries, which would lead to better policy implementation.

There were other reasons for the dissatisfaction with project aid. This modality had high transaction costs, because every donor held separate deliberations with the government for every project, which continuously produced new rules for tendering, implementation, reporting and evaluating. Project aid was also quite unpredictable. And donors ran many projects themselves, so there was little harmony between the various projects, and the governments' capacity to plan and implement their own development policies was weakened. Donors frequently hijacked the best people from governments as well, which further weakened the governments. Often, the results of projects were not sustainable since projects were not always a government's policy priority: governments did not always take over or maintain a project once a donor pulled out of it, and as a result the positive impact went to waste. And finally, it was not sure either whether donors were financing the good causes they had in mind with these projects. Since money is fungible, donor resources can ultimately be spent differently than intended in the development project.[8]

7 The *Heavily Indebted Poor Countries* (HIPC) programme was established in 1996 with the support of the international financial community. The programme aimed to reduce the debt of the poorest developing countries to a sustainable level. In 1999, the programme was expanded to become the *Enhanced HIPC Initiative*, which not only included more countries but also provided further debt relief. The conditions for debt relief were a solid and sustainable economic policy, and a policy that aimed to reduce poverty. This initiative had two phases: the Decision Point, when it was determined whether countries were eligible for debt relief, and the Completion Point, after which debt relief is definitely granted.

8 For example, the project financed by the donor is a school, but because the government had been planning to build the school anyway, the money is used to buy a tank.

2.3 The anticipated impact of budget support

Switching from project aid to programme aid (budget support) should therefore result in better coordinated development projects run by governments, reduced transaction costs, enhanced capacity in recipient countries, more aid predictability and more sustainable development results. Moreover, there was an anticipated political effect as well: if donor money was to be included in the budgets and budget reporting, and if this reporting were to become more transparent, parliaments and civil society could call governments to account about how these resources are spent. Budget support would also place a great deal more ownership in the hands of recipient countries, compared to both project aid and earlier forms of programme aid, which would therefore result in more effective implementation of development policies. Moreover, this modality of aid was viewed as crucial for achieving the Millennium Development Goals. The goal of providing more budget support perfectly suited the changing outlook on development cooperation in the late 1990s. *More* aid would be given, and this aid would be aimed *more* at fighting poverty and helping the social sectors. From now on, aid would have to be more effective as well. These notions about more effective aid were later solidified by the declarations of Rome (2003), Paris (2005) and Accra (2008). Effective aid would have to be founded on the principles of ownership, alignment, harmonisation, managing for results and mutual accountability. According to the Paris Declaration, in 2010 two thirds of all aid would have to be based on national plans. Among these programme-based approaches, budget support was viewed as an ideal modality to achieve the principles of the Paris Declaration.

Ownership plays an important part in budget support's anticipated improved effectiveness. But donors attribute various meanings to this notion. The meaning that comes closest to daily usage is that recipient countries have complete say and control over such policies (Whitfield and Fraser 2009: 4). But, as Whitfield also points out, many donors define ownership implicitly as commitment *to the donors' reform agenda*. Booth (2011) writes that ownership is about a country being committed to development: 'country ownership of development efforts' (Booth 2011: 5). If countries are committed to development, donors should feel confident about transferring freely disposable resources to governments, but this commitment is not automatically present.

The question, then, is how donors can determine whether this commitment to development is present. In the new aid approach, PRSPs and other development plans play an important part in this. According to the Paris Declaration, ownership means that recipient countries assume leadership in setting up and implementing national development strategies, and that they also convert them into result-driven operational programmes. Donors have to respect this leadership and, when needed, reinforce it (OECD 2005).

The problem with this definition of ownership is that it is not about the content but merely about the process: Of course countries can develop strategies and result-driven plans, with donor help if need be, but that does not say anything about their actual preferences, intentions and implementation capacity. The Paris Declaration actually assumed that

donors and recipient countries at least had a common intention to fight poverty, and that countries would therefore actually implement the strategies. In fact, ownership presupposes a degree of selectivity.

The expectations raised by the new aid approach about the positive impact of budget support can be summarised in a policy theory. The policy theory used here is based on previous frameworks developed by White (1999) and IDD et al. (2007), but has been reduced to its essence in Table 2.1. The two budget support inputs are financial resources and selectivity. If certain conditions regarding good governance and good policy are met, then donors agree in principle with the recipient's policy, and donors can probably respect 'ownership'.[9] The detailed evaluation framework for the joint evaluation of general budget support (IDD et al. 2007) does not only incorporate level '1', the inputs, but also a level '0', the preconditions. This includes not only the conditions that the recipient country must meet, but also the conditions for the donor ('donor readiness'): are donors prepared to relinquish control over how their resources are spent for a longer period of time? Of course, this partly determines whether donors will respect ownership at the implementation level (level 2, or 'immediate effects' in IDD et al. 2007).

Respecting ownership is expected to result in better policy implementation on the output level and therefore also in more effective policy. When budget support resources are completely freely disposable, then there is alignment with the priorities and with the various (planning, budgeting, procurement, implementation and accountability) systems in the recipient county (see Table 2.1, right column). These resources are expected to be harmonised among donors and to be provided in a predictable way. The former can be determined by the number of participating donors and by how much of their aid is in the form of budget support. According to some people, donor harmonisation with budget support will lead to *more* ownership among recipients. Recipients will be more strongly encouraged to develop their own policies and set them down in plans and projected results, because these plans will subsequently receive financial support from the donors (Bigsten et al. 2011). According to others, *more* donor harmonisation negatively impacts 'ownership' because joint donors will determine recipients' agenda to an even *larger* extent in countries dependant on aid (Whitfield 2009; Booth 2011).

If alignment, harmonisation and predictability are achieved, then the outputs in the right-hand column in Table 2.1 should be realised. And if this is the case, then governments should become more effective in planning and implementing their services, so that they can deliver more and better quality services that focus more on the poorest communities. This enhanced government effectiveness can also be the result of better policy implementation as a result of 'ownership'.

[9] De Kemp et al. (2011) make a distinction, in line with the Paris Declaration and IMF definitions, between agreement or disagreement on preferences between donors and recipients, and 'ownership' in the sense of taking active responsibility for achieving results and the willingness to make resources available for this purpose. This may vary per sector.

Table 2.1: Policy theory for budget support according to the theory of the new aid approach				
Inputs	Selectivity	Resources		
Implementation	Respect for ownership	Alignment	Harmonisation	Predictability
Outputs	Better policy implementation	Strengthening local systems as a result of use; Greater output with the same resources through lower transaction costs; *More* resources for social sectors More local accountability		
Outcomes	Enhanced government effectiveness			
Impact	*Greater* poverty reduction			

Enhanced government effectiveness in service delivery and greater focus on poverty by governments should result in *greater* poverty reduction (the ultimate impact). This last step, however, is not so well thought-out in the intervention theory. Substantial attention was devoted to the Millennium Development Goals at the beginning of the millennium, especially better access to education, health care and water. Enhanced government effectiveness has an immediate impact on these goals, and they fit within a broad view of poverty reduction. But in practice, donors also want to reduce *income* poverty with GBS. It is less clear, however, what governments can contribute to this objective. Better access to basic services only has an indirect and longer-term impact on income poverty.

Another problem with this policy theory is that it does not cover the whole range of ideas in policy makers' minds. The Paris Declaration puts considerable emphasis on improvements that are necessary on the giving end of the aid relationship, but at the same time, the idea prevailed that much has to be improved on the receiving end (Renard 2006). According to this view, *too few* conditions for policy and governance were made in the past, and budget support could be used to improve policy and governance. In that respect, Rogerson (2005) talks of donor 'schizophrenia', because the Paris Declaration makes no mention of conditionality, though in practice donors still set conditions (Rogerson 2005).

A more critical attitude towards aid was voiced in scientific studies that described the neo-patrimonial system and the corresponding corruption that existed especially in Africa (Chabal and Daloz 1999, Van de Walle 2001, Van der Veen 2002). Aid to governments in Africa was perpetuating this system. Aid, and budget support in particular, also resulted in governments becoming less dependent on the support of their own people. This made it more difficult to build a democratic state. By lowering income taxes, governments made themselves less accountable to their people and parliaments (Sogge 2002, Moss et al. 2006, Moyo 2009, Boekestijn 2010). We will discuss empirical research on these effects later in this report (section 4.5 and chapter 5).

More critical authors also emphasise that budget support is 'fungible' and that donors run the risk that partner countries will finance things that were not intended. Budget support is not earmarked aid, however, so the problem of fungibility (that the resources are used for

something other than intended) is theoretically not an issue. Fungibility can be a problem at the macro-level, however, when aid leads to the lowering of tax revenues, for example.[10] Another concern is that budget support resources may disappear into the pockets of corrupt leaders. Experience shows, however, that this is not a problem specific to this modality. The use of a large number of funds and resources for projects is exactly what contributes to greater budget non-transparency, which makes it easier to misappropriate development money. In addition, providing general budget support gives donors an argument to interfere more extensively with budget management and control.

The 'High Level meeting' in Accra, which followed the Paris meeting, attempted to reconcile a number of ideas. 'Ownership' by recipient countries was still viewed as important in the Accra Action Agenda (OECD 2008) and was broadened to include 'ownership' by inhabitants, not just governments. At the same time, the word conditionality started to crop up. Conditionality would have to be applied 'in support of ownership'. The process would work as follows: the number of conditions should be limited; they should be derived from the national strategies of the countries themselves; they should be as result-driven as possible; and they should be harmonised between donors to the greatest extent possible. This coincided with what is called 'good practice' conditionality in the literature on the new aid approach. Conditionality that respects 'ownership' must give the recipient country a substantial voice in the policy dialogue about conditions, and the conditions have to be primarily outputs and outcomes and not policy measures or activities (Adam and Gunning 2002, Dijkstra 2005, Molenaers and Nijs 2009). The more compatible the original preferences of donors and recipients are, the easier it will be for donors to apply these recommendations. If the preferences are the same, as a result of applying selectivity, for example, then there will be hardly any need for conditionality any more. In that case, the recipient will essentially always want to implement the policy conditions.

In practice (see also chapter 5), selectivity has not been applied very strictly, and donors have quickly, to a greater or lesser degree, started using the policy dialogue on budget support to bend the policy and institutions in recipient countries towards their own wishes. This has resulted in even more conditions, which rely less on the wishes and plans of the recipient country, and so policy measures will be prescribed more often instead of making agreements about output objectives. Essentially, budget support will then have two objectives: not only more effective poverty reduction by means of ownership and by providing freely disposable resources, but also improving governance and policy by means of the policy dialogue linked to budget support.

Some more recent views of budget support inextricably link this second objective to this aid modality. Budget support is 'not a blank cheque'; it is a package that also consists of the policy dialogue and performance agreements (Leiderer 2010; De Kemp, Leiderer and Ruben, 2011). Koeberle and Stavreski write that budget support presents the opportunity

[10] This distinction is based on White (1998), who distinguishes between 'categorical fungibility', in which aid is transferred to other spending categories than originally intended (tanks instead of schools), and 'aggregate fungibility', in which, for example, government spending or imports do not increase commensurately with aid.

'… to address key cross-cutting issues such as public sector reform, public financial management, or improvements in governance. Budget support typically aims to promote pro-poor growth through encouraging fiscal and macroeconomic stability and more efficient allocation of public funds' (Koeberle and Stavreski 2006: 5).

This view presupposes a different policy theory, in which budget support has two objectives. The objective to improve policy and governance is not only an objective in itself, but donors see aspects of it also as a way of promoting economic growth and poverty reduction. Section 2.4 discusses in more detail the different definitions of good policy and good governance, and the presumed relationship between elements of good governance and economic growth.

'Better policy and better governance' has been added in Table 2.2 at the impact level. But because good policy and good governance can also be instrumental to reduce poverty, these elements are also part of the outcome level. The inputs change too. In addition to freely disposable resources, there is still selectivity by setting entry conditions. Whether these entry conditions have been met and to what extent, then, there is agreement between the donor and recipient on preferences will have to be empirically determined. But in addition to entry conditions, donors also have preferences for the policy dialogue and 'triggers'. The latter are specific conditions that determine whether budget support can be continued. These preferences can relate to political–governance issues, often laid down in 'underlying principles' in an agreement about budget support (elections, rule of law, human rights and control of corruption), to the implementation of certain policies (privatisation), or to achieving a certain objective (a higher percentage of children attending school, for example).

The outputs of budget support depend on the way this modality takes shape. At the 'implementation' level, we examine to what extent donors respect ownership or try to influence policy and governance; this will depend partly on the degree to which selection criteria were used. When all donors are convinced that the recipient agrees with them about what policy to implement, harmonisation of donors is not necessary nor is it an issue (Booth 2011). If this agreement is absent, however, it becomes important to examine to what extent donors have harmonised their priorities and triggers. Donors are generally expected to have more influence on recipients if they join forces in setting preferences for policy dialogue and triggers. But this harmonisation is at the expense of the recipient's sovereignty.

With outputs, it is important to examine whether the recipient country is carrying out changes in governance or policy in line with the donor's wishes. If this occurs, and if this implemented, this is expected to improve policy and governance, leading to positive outcomes in the form of less corruption, for example, or a better investment climate.

Table 2.2: Actual policy theory on budget support

Inputs	Selectivity and preference for the policy dialogue		Resources		
Implementation	Harmonisation	Respect for ownership or attempt to influence	Alignment	Harmonisation	Predictability
Outputs	Implementation of policy or desired changes by donors to policy and governance		Strengthening local systems as a result of use; Greater output with the same resources through lower transaction costs; More resources for social sectors More local accountability		
Outcomes	Enhanced government effectiveness; Better policy and better governance				
Impact	*Greater* poverty reduction; Better policy and better governance				

The other parts of the policy theory do not change, but the odds of the outputs and outcomes being achieved diminish if there is little agreement about priorities and preferences between donors and recipients. The two objectives of budget support now mentioned can be incompatible sometimes. Many of the anticipated benefits of budget support are based on ownership in the sense of a recipient agreeing with the donors' desired policy. The further away donor preferences in the policy dialogue are from the recipient's, the more the anticipated impact of budget support will be undermined. First, attempts by donors to influence policy and governance will increase transaction costs, both for donors and the recipient. Second, donors will not always agree on the conditions, which can endanger harmonisation: every donor emphasises different things in the policy dialogue and in the conditions for continued budget support. Third, when the preferences between donor and recipient differ, transfers may be suspended. This potential threat has a negative impact on predictability. Fourth, less ownership endangers effective implementation of the policy desired by donors. And fifth, the attention governments must devote to discussing the wishes of donors can also impede better accountability to domestic actors.

2.4 Good policy and good governance

2.4.1 General

Donors attach various meanings to good policy and good governance. Sometimes only good governance is mentioned implying that good policy is part of that. In this study, we do distinguish between policy and governance. Policy is what governments *do* to promote economic growth and poverty reduction. In this context, it therefore usually concerns social and economic policy. Examples are whether or not to make primary education free, determining the budget for education, determining teachers' wages, determining the

import tariff on cars or computers, etc. Governance is the entire entity of institutions that determine *how* governments make and implement policy.

In good governance theory, a distinction is made between elements of governance concerned with access to (government) authority, and elements that concern exercising government authority (Rothstein and Teorell 2008). Issues such as democracy and democratic accountability fall under the former, while control of corruption, government effectiveness and rule of law, including respect of property, fall under the latter.

Donors frequently make a somewhat comparable distinction between political and technocratic elements of good governance. Political governance in this case certainly concerns democratic rights, such as free and fair elections, but also civil rights, such as freedom of expression and freedom from state violence. Technocratic governance includes elements such as a transparent and effective government, among others, by means of improved financial management of the government, control of corruption, property rights protection, regulatory quality and rule of law. Sometimes decentralisation is part of this as well. The International Financial Institutions limit themselves to promoting technocratic governance, partly because they are not authorised to interfere in the politics of recipient countries. But the dividing line between technocratic and political elements is not always clear. Fighting corruption, promoting the rule of law and decentralisation can only succeed if political changes take place as well.

When we look at how donors have operationalized 'good governance', the Country Policy and Institutional Assessment is an indicator that combines good policy *and* good governance (according to our definition). Parts A to C (economic management, structural policies and policies for social inclusion/equity) concern policy; part D (public sector management and institutions) and the 'governance cluster' concern good governance, in particular its technocratic elements such as public financial management, government effectiveness and transparency and issues such as rule of law, protection of property rights and regulatory quality. Van Waeyenberghe (2009) shows that the sub-indicators for parts A to C (policy) in the CPIA still reflect neo-liberal ideology: less government is always better. This is also true of the governance cluster, which actually also contains policy elements, such as regulatory quality. There are also contradictions in the CPIA, because in governance a country receives a higher score when the labour market is flexible, for example, while in part C protecting employees is regarded as positive.

The Kaufmann indicators are all about governance and cover all of its dimensions: political stability, freedom of expression and democratic accountability, regulatory quality, rule of law, control of corruption and government effectiveness. Just like the CPIA, the scores are based on perceptions. Yet, these Kaufmann indicators can also be criticised (Dijkstra and Vandewalle 2011).

2.4.2 The relationship between development and good policy/ good governance

Good policy is not an objective in itself, but a means of promoting economic growth and poverty reduction. What this policy means in concrete terms is less clear. Economists do agree that governments have to ensure macro-economic stability and that overvalued exchange rates should be avoided. But apart from that, opinions often differ as to what good policy should be. Good policy also depends on context. It is therefore anything but clear whether what donors consider 'good policy' will always lead to economic growth and poverty reduction, and there are many examples of bad advice in the past.

Promoting good governance can, however, be seen as a development objective in itself. This is certainly the case for political good governance: respect for democratic rights and human rights are values that are in themselves worth pursuing. But this is also true for the more technocratic elements on the good governance agenda: rule of law, control of corruption and better provision of services by the government improve quality of life.

There is even less evidence to support the idea that good governance is a condition for socio-economic development and poverty reduction. The relationship between democracy and economic growth has often been empirically researched, but no robust relationship has been found (De Haan and Siermann 1995, Doucouliagos et al. 2006). Chang shows, in a historical study, that today's developed countries had a more authoritarian system in their early stages of development than low-income countries now (Chang 2002).

There is empirical evidence pointing to a relationship between the level of economic development and other elements on the good governance agenda, such as little corruption, an effective constitutional state that respects property and a government that acts impartially. This leads some authors to conclude that these kinds of institutions are a necessary condition for development. North et al. (2009) argue that political stability is important and that this can be achieved through closed and open societies. In closed societies, a small elite controls all political and economic power, whereas essentially anyone in an open society can contribute to and benefit from the fruits of development, based on capacities. These authors suggest that open societies, characterised by the rule of law and a Weberian government bureaucracy, enjoy stronger economic growth than closed societies. But empirical evidence for this is lacking. Various studies attempt, by means of empirical research, to establish a causal relation between these kinds of good governance conditions and economic growth (see Dijkstra and Vandewalle 2011). But a major problem is that the indicators for good governance have only been available since 1996, so nothing can be said about how necessary these institutions were for economic growth to take root in what are now the wealthy nations.

Acemoglu et al. (2001) have attempted to make pronouncements for the longer term. They compare colonies where white colonisers had settled to colonies where this was not the case and argue that countries where whites had settled have better property rights than other countries. The reason for this is that the inhabitants needed these property

rights. The colonisers in the other countries were only interested in removing valuable raw materials and goods, by force if necessary, and so it was in their interest to deny property rights. The authors used exogenous variables as instruments to classify countries that had or did not have settled colonisers, and show that the countries that had settler colonies have much higher incomes per capita today than the other countries. Khan (2010), however, argues that these findings are based on a false premise. Countries where colonisers had settled also experienced frequent violence against the indigenous people, and the (original) property rights were destroyed there as well. Acemoglu en Robinson (2012) elaborate on their earlier empirical studies in *Why Nations Fail*. They argue that both a centralised state and 'inclusive institutions' are necessary for economic growth. Countries with 'extractive institutions' (such as the countries where colonisers did not settle) are not growing.

Other authors are not convinced that these kinds of institutions are necessary for economic growth. Chang (2011) believes it is more likely that economic development fosters the emergence of these institutions. Today's developed countries had a much lower level of institutional development (in terms of property rights, rule of law and control of corruption) than do today's developing countries (Chang 2002, Goldsmith 2007). It is also possible that a third factor is responsible for both growth and for the development of institutions (Kurtz and Schrank 2007). Khan (2010: 15) shows graphically that there is little difference in good governance indicators (democracy, corruption and rule of law) between developing countries that are growing quickly and slowly. Therefore, there must be other factors that explain the high growth.

Indeed, Khan (2007) refers to 'market enhancing governance' versus 'growth enhancing governance'. Historically, growth enhancing governance, as witnessed in authoritarian regimes such as China has been more important for economic growth than the kind of governance embedded in in the Kaufmann indicators. A pairwise comparison between four African and four South-east Asian countries shows that the higher growth in South-east Asia is primarily due to different policies. There was just as much corruption in Asia as in Africa, and there was little difference in terms of democratic accountability (Van Donge et al. 2012).

Another reason for putting less emphasis on the importance of good governance as a condition for development is that investing in institutional change is extremely costly, both financially and politically. Therefore, this has to be weighed against other investments (Rodrik 2007). But donors usually believe that countries should implement the entire list of conditions for good governance, while good results could probably be achieved with 'good enough governance' (Grindle 2004). The context is important as well. Some imposed reforms may backfire, for example because they mean the end of already existing, well-functioning informal institutions (Rodrik 2008).

More recent studies conclude that institutions are an important part of development, but that several paths can be chosen to achieve development (Levy and Fukuyama 2010, Levy 2010). Countries in East Asia owe their high economic growth to a strong state (developmental state) and a centralised power that was aimed at the growth of the nation as a whole. Only much later did they begin to develop political (democratic)

and market-oriented institutions to protect property rights and the rule of law. Other countries, such as Bangladesh, apparently had 'good enough governance' and could attain strong growth by changing crucial aspects of policy and sometimes of governance as well. Countries in Africa have also enjoyed periods of strong economic growth despite neo-patrimonial governance with corruption and clientelism. Conditions for strong growth are a strong central authority that is focused on the long term and a market-driven policy that benefits rural areas (Kelsall 2011).

2.5 Conclusions

The intervention theory of budget support argues that donors and recipients should become partners in development from now on and that substantial amounts of budget support would help reduce poverty. This expectation will only be met if there is some fundamental agreement between donors and recipients about the priority for poverty reduction policies and if recipients are capable of implementing these policies. These conditions have often not been met.

At the same time, donors want to use budget support to exert influence on policy and, increasingly, on governance. Apart from the fact that previous research has shown that such influence is only marginally possible, the two objectives of poverty reduction and good governance can also be incompatible.

3

Policy

3.1 Introduction

On 5 April 2012, the Ministry of Foreign Affairs suspended development aid to Mali after a military coup took place in the country. As a result, the future of general budget support to the last remaining country looked uncertain, thus heralding the end, even if temporary, of a decade that saw development aid blaze a new trail.[11] It was a decade in which harmonisation and ownership had become, at least in name, central tenets of development architecture. Large international conferences, such as the ones held in Rome (2003), Paris (2005), Accra (2008) and Busan (2011) characterized this way of thinking. And budget support fit into this mould.

This chapter outlines the development of Dutch policy, with an emphasis on the period 2000–2012. Section 3.2 begins by outlining the policy development. Based on this, section 3.3 reconstructs the policy theory and intervention logic. Section 3.4 continues with the implementation, including the conditions, the financial development and the administration, respectively. Section 3.5 gives a picture of the characteristics of countries that have received budget support from the Netherlands. This section compares these countries to partner countries that do not receive support. Section 3.6 draws conclusions.

3.2 Policy development

3.2.1 Minister Pronk (1989–1998): Programme aid if possible

Although the ministry began to allocate (general) budget support at the end of the 1990s in particular, this was not strictly speaking a new instrument. Programme aid started to flourish as early as the 1980s as a result of absorption problems in project aid and balance of payments problems. The most important objective was to contribute to macro-economic stability in recipient countries. Import support, for example, grew in importance in the mid-1970s as a result of increasing balance of payments problems in many countries. In the late 1980s, it was the most important form of Dutch programme aid, with an average total amount of €390 million a year (about 25% of bilateral aid) for the period 1985–1988.[12] A large part of this aid went to a limited number of countries, including Bangladesh, India, Tanzania, Mozambique and Kenya (see table 3.1).

[11] In 2012, Bhutan, Burkina Faso and Mozambique still received general budget support, but for Bhutan and Mozambique this will be discontinued after 2012 and for Burkina Faso after 2013.

[12] Import support consists of donors financing imports with hard currency. The instrument was often used to support economic adjustment programmes. Governments in recipient countries would set up *counterpart funds*, in which the recipients of goods financed by import support paid the value of these goods to the government in local currency. The Netherlands financed import support from a) the programme for balance of payments support and b) country and regional programmes. In practice, however, it often concerned tied assistance, in which recipients were obliged to spend the aid in the Netherlands. Part of it also concerned the direct supply of goods to the Dutch business sector, partly financed from import support resources.

The 1991 policy document *Een wereld van verschil* (A world of difference) referred to programme aid as the ideal form of aid to support good socio-economic policy in a country (TK 1990–1991, 21 813, nos. 1-2). The document expressed the expectation that this modality would become increasingly important in coming years. Recipient countries needed to receive a greater degree of ownership through freely disposable programme aid or (sector) budget support (see pp. 301–302). The more *agreement* with policy in the recipient country, the fewer conditions would have to be set for the support.

Table 3.1: Development programme aid to selected countries (1988–1993; in millions of euros)

	1988	1989	1990	1991	1992	1993
Bangladesh	29.0	20.3	26.9	31.4	24.3	2.0
India	69.0	40.4	63.6	43.8	68.7	28.2
Kenya	23.5	25.7	29.2	13.4	15.7	9.5
Mozambique	31.5	21.0	32.9	27.0	25.7	13.8
Pakistan	11.3	11.3	13.6	11.3	8.2	2.9
Tanzania	38.8	40.1	50.9	38.0	19.6	19.4
Zambia	7.9	3.1	23.7	17.5	16.5	9.2
Zimbabwe	8.5	5.6	8.7	7.2	14.7	11.3
Total	**219.5**	**167.4**	**249.4**	**189.5**	**193.2**	**96.3**

Source: 1994 Annual report of the Dutch Court of Audit

The practical significance of budget support nevertheless remained limited, in part because of uncertainty about the *institutional capacity* of the countries whose socio-economic policy made them potentially eligible for it (TK 1994–1995, 24 045, nos. 1–2, p. 11). Other forms of programme aid, such as import support and balance of payments support, and especially debt relief, remained more important. But there was not a significant rise in spending in these cases either. The liberalisation of the exchange rates in many development countries meant that balance of payments support had lost its core significance. The desire to phase out aid further contributed to import support – part of which could be called export support – falling into disuse in the Netherlands.

Table 3.2: Development programme aid 1994–1997 (in millions of euros)				
	1994	1995	1996	1997
Modality:				
Macro-support	56.7	85.8	85.6	46.3
Debt relief	120.6	238.5	153.7	61.1
Sector support	57.5	44.9	40.7	31.7
Region:				
Asia	59.6	77.2	54.9	9.1
Middle East	6.5	17.3	30.6	17.2
Africa	115.4	185.6	128.1	79.0
Central and Latin America	26.0	70.6	50.6	22.8
Eastern Europe	27.3	18.4	15.9	10.9
Total	**234.7**	**369.2**	**280.1**	**139.1**

Source: Dutch Court of Audit (1999)

3.2.2 Minister Herfkens (1998–2002): From project aid to sector support

Policy changed with the arrival of a new minister in 1998. The new minister had worked at the World Bank for several years and brought the organisation's prevailing ideas about development cooperation back to the Netherlands. She intended to considerably limit the number of countries with whom the Netherlands maintained structural bilateral development relations. Much more than previously, she wanted to choose these countries – in line with the dominant notions about aid effectiveness at the time – based on their degree of poverty, the quality of governance and the quality of the socio-economic policy (TK 1998–1999, 26 433, no. 1). The central tenet in international thinking – and the World Bank in particular – at the time was that aid could only be effective in countries with good policy. The influential publication *Assessing Aid: What Works, What Doesn't and Why* (World Bank 1998), which made this link empirically, played an important part in this:

'The World Bank publication Assessing Aid has clearly outlined the importance of good policy and good governance. The recent, welcome publication by the United Nations Economic Commission for Africa, The Challenges of Financing Development in Africa, also emphasises that aid is ineffective or even harmful in an inadequate policy environment. The same document argues that more effective aid allocation based on relative poverty in development countries and the quality of their policy programmes would dramatically improve the impact of aid on poverty reduction' (TK 1998–1999, 26 200 V, no. 88, p. 18).

The report's implications contributed to an important paradigm shift in development cooperation, from *conditionality* to *selectivity* – not only at the World Bank, but also in the Netherlands and other countries (see Easterly 2003, for example). According to the *conditionality concept*, inadequate policy and governance could be improved by means of

a long-term development relationship with conditional financial support. The *selectivity concept* was completely at odds with this. Money cannot buy reform according to the selectivity principle, and conversely, aid can only be effective in countries with good policy and governance (IOB 1989, pp. 13-14).

In line with these developments, the minister introduced good governance both as a criterion for the selection of partner countries and for allocating programme aid (IOB 2008, pp. 159-160). The sector-wide approach was to become the cornerstone of the new bilateral policy, but the choices would also have important consequences for macro-programme aid. The declining importance of import support and debt relief reduced the importance of incidental programme aid, paving the way for budget support to become the most important macro-instrument. Moreover, the instrument would be primarily reserved for partner countries.

The minister selected a group of 19 partner countries based on the following three criteria: 1) degree of poverty, 2) quality of governance, and 3) quality of socio-economic policy. These 19 countries were: Bangladesh, Bolivia, Burkina Faso, Eritrea, Ethiopia, Ghana, India, Yemen, Macedonia, Mali, Mozambique, Nicaragua, Pakistan, Sri Lanka, Tanzania, Uganda, Vietnam, Zambia and Zimbabwe. In addition, aid to Egypt, South Africa and the Palestinian Territories received a time limit.[13] The selection of these countries was based on both quantitative criteria and, to a greater extent, qualitative considerations.[14]

Focusing on a group of about 20 partner countries did not mean that other countries would no longer receive bilateral aid. The minister considered it desirable to have a broader selection of countries for three theme-oriented instruments (in which a pre-existing Dutch presence also played a role; TK 1998–1999, 26 433, no. 1):

a *Environment*: Brazil, China, Colombia, Ecuador, Philippines, Guatemala, Cape Verde, Mongolia, Nepal, Peru and Senegal.
b *Good governance, human rights and peace-building (GHP)*: Albania, Armenia, Bosnia, Cambodia, Colombia, El Salvador, Georgia, Guatemala, Guinea-Bissau, Honduras, Kenya, Moldova, Namibia, Nepal and Rwanda.
c The *business community programme* was limited, besides the partner countries, to the following countries: Armenia, Bosnia, China, Colombia, Cuba, Ecuador, El Salvador, Philippines, Georgia, Guatemala, Cote d'Ivoire, Jordan, Cape Verde, Moldova, Nigeria, Peru and Thailand.

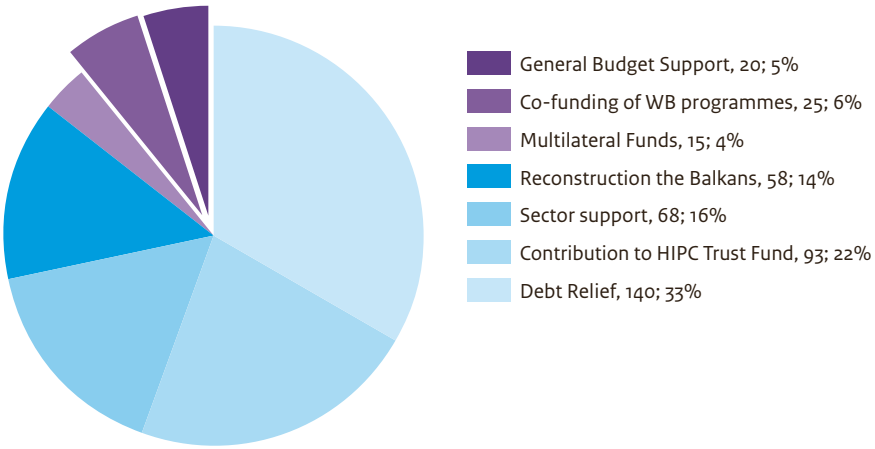
In December 1999, the minister presented a memorandum on macro-oriented programme aid, which had been announced that spring (TK 1999–2000, 26 433, no. 22). She indicated

[13] A motion by member of the house Van Ardenne–Van der Hoeven quickly bumped Pakistan and Zimbabwe off the list. Indeed, the House of Representatives deemed support to these countries undesirable as a result of their participation in armed conflicts and violation of human rights. The House of Representatives requested that Indonesia be put on the list. Thus, the minister continued with '17+4' countries. Benin and Rwanda were added later.

[14] It is precisely the introduction of more political considerations, in addition to a lack of transparency, that led to criticism of the consistency of the selection process.

that macro-support would be a comprehensive part of the aid package to countries with which the Netherlands maintained a structural bilateral relationship. In addition, a number of former communist countries in Eastern Europe would be eligible for macro-support, providing they too met the conditions for good governance. Incidental macro-support would remain available for other countries, for example in emergency situations.

Figure 3.1: *Distribution of programme aid in 1999 (amounts in EUR million)*



Source: Macro letter 2000

The scope of general budget support was still very limited at the time (see figure 3.1). The largest part of macro-support at the time consisted of debt relief (55%). The Netherlands provided general budget support to Cape Verde, Mali, Mozambique and Macedonia, and it co-financed World Bank support to Kyrgyzstan, Georgia, Yemen and Ghana. The total amount did not exceed €45 million.

The modality did not receive prominent status in ensuing years either. The focus was much more on gradual growth, in which existing development relations and programmes were decisive for granting general budget support. Aid to Mali is an example. The Netherlands provided macro-support there from the 1990s onwards, including both debt relief and contributions to financing structural adjustment programmes. Granting budget support was often linked to the emergence of Poverty Reduction Strategy Papers (PRSPs) as a consequence of the HIPC initiative. In *Mozambique*, the government and a dozen donors sealed a multi-donor agreement in 2000 for macro-support for a three-year period in order to help implement (with an emphasis on good governance) the Mozambican poverty reduction strategy (IOB 2008, p. 170). A multi-donor approach was also used in *Tanzania*, where the Netherlands had been providing general budget support since 2000, as a consequence of the HIPC initiative to support the Tanzanian poverty reduction strategy. *Burkina Faso* received budget support from 2011 onwards. This country completed its PRSP in 2000 and reached the HIPC Decision Point that year, but the involvement of President Blaise

Compaoré in the civil war in Liberia and diamond smuggling in Sierra Leone formed an obstacle at that time for granting the country general budget support (IOB 2008, p. 167).[15]

Spending increased in the first years of the new millennium, but this was primarily the result of incidental budget support, which was also connected to the wide availability of resources at the time (IOB 2008, p. 169; see also figure 3.2). Examples of incidental support include the aid to *Burkina Faso* in connection with a deteriorating exchange rate and the rehabilitation support to *Mozambique* as compensation for the consequences of the flood disaster in 2000.[16] Mali received additional incidental budget support in 2000 because of its contribution to the UN forces in Sierra Leone. In 2001 *Ghana* received extensive incidental budget support (€80 million) as compensation for its contribution to the UN ECOMOG peacekeeping force in Liberia. Regular budget support to that country had been taking place for a while now by means of co-financing with World Bank programmes.

3.2.3 Minister Van Ardenne (2002-2007): Growth of the instrument

3.2.3.1 Budget support if possible

In 2002, the cabinet resigned as a result of the report on Srebrenica by the NIOD, the Institute for War, Holocaust and Genocide Studies. In the next cabinet, Agnes van Ardenne became Minister for Development Cooperation.

Van Ardenne laid down her policy in the document entitled *Aan Elkaar Verplicht* (Mutual interests, mutual responsibilities) (TK 2003–2004, 29 234, no. 1). This document outlined three main objectives:

- increased commitment to the Millennium Development Goals (MDGs);
- increased quality and effectiveness of development cooperation; and
- make apparent the priorities and results of Dutch efforts.

The minister wanted policy to focus on a limited number of themes and countries, and she chose to broaden the focus in Africa (at least 50% of the bilateral budget). A list of 36 partner countries was compiled for the bilateral policy that focused primarily on the *promotion* of good governance, respect for human rights and capacity enhancement.[17] There was also a further shift from good governance as a condition for bilateral aid to good governance as an objective:

[15] In anticipation of the results of the UN Security Council deliberations, the Netherlands decided in 2000 to suspend the €7 million of budget support that had already been granted due to accusations that the country was evading sanctions against UNITA and Sierra Leone. The Netherlands entered into a three-year agreement for structural budget support the following year, despite serious violations of human rights in Burkina Faso (IOB 2008, p. 168).

[16] The donor community, incidentally, suspended disbursements for several months in response to a corruption scandal in the banking sector. After the Mozambican government gave what was considered an adequate response, disbursements were resumed towards the end of the year.

[17] The list of 36 countries was largely an amalgamation of the '19+3' partner countries, the 15 good governance–human rights–peace-building countries and 8 environmental countries (that did not belong to the former group). This amalgamation was in line with the recommendation of the working group. See also Annex II.

'As a condition for sustainable poverty reduction, good governance will assume a more central position in development cooperation. Good governance will not be an absolute criterion, however, used to grant or deny a country the status of partner country. In evaluating the quality of governance, the main concern is whether the changes taking place are inspiring sufficient confidence. Efforts almost always concerned developing or transition countries where weak governance was by definition an impediment to fighting poverty effectively. However, partner countries must at least demonstrate the intention to implement good governance, as well as measures for improvement, if effective cooperation with them is to be possible' (p. 7).

The document dovetailed with the recommendation that appeared shortly before by the *Werkgroep Effectiviteit en Coherentie van Ontwikkelingssamenwerking* (a working group on effectiveness and coherence of development cooperation), which had emphatically spoken out in favour of general budget support (actually as the second-best option after multilateral aid).[18] The working group assumed that budget support would help to reduce transaction costs, make the budget process more transparent and the allocation of aid more effective. General budget support would also prevent the budget from being 'thrown out of balance' by sector budget support (TK 2003-2004, 29 234, no. 2, p. 70).

Although the minister supported the flexible use of aid modalities, she also expressed a preference in *Mutual interests, mutual responsibilities* for general budget support. She did, however, attach several conditions to it:

'In the first place, budget support must be directly linked to the PRSP process. That process has to make sure that the starting points for partnership, the commitment of various groups at the country level and the translation of the MDGs into local policy are given sufficient space to develop. Second, the on-budget financing must go hand in hand with an effective policy dialogue with the recipient country in the areas of good governance, including its political dimension, and poverty reduction. Third, this financing must be based on results measured by progress indicators for institutional and policy reforms that are clearly agreed on beforehand' (p. 21).

These indicators, laid down in result matrices called *Performance Assessment Frameworks* (PAFs), subsequently served as the basis for the dialogue:

'In countries that receive budget support, the PAFs must serve as the basis for the political dialogue between donors and the government. Donors can use this dialogue, as well as support from reform programmes, to exert influence on the process of improving governance and reducing risks (corruption, for example)... The advantage of using PAFs is that donors pursue the dialogue together with the partner country and can exert joint pressure in favour of reform' (TK 2005–2006, 30 300 V, no. 19, p. 7).

[18] See *Effectiviteit en Coherentie van Ontwikkelingssamenwerking, Eindrapport van de werkgroep Effectiviteit en coherentie van ontwikkelingssamenwerking*, Interdepartementaal Beleidsonderzoek, 2002–2003, no. 1 (TK 2003–2004, 29 234, no. 2).

The quotes make it clear what some of the starting points are for (general) budget support:

1 whereas good governance was initially a condition, it increasingly became an objective, though it should be noted that good governance was viewed as a condition for poverty reduction;
2 to achieve that goal, the policy dialogue also gained in importance;
3 budget support had to be linked to the national development strategy (PRSP), which almost linked the instrument by definition to the HIPC initiative;
4 budget support did not only aim to reduce (income) poverty, but focused just as much on achieving the MDGs;
5 the memorandum assumed that progress on a number of indicators would be easy to monitor. This also required the progress indicators to be SMART: specific, measurable, attainable, relevant and time-bound.

These five starting points were in line with international notions about budget support (see also chapter 2).

The impact of policy changes under Van Ardenne, with a greater preference for general budget support, became evident in the 2004 *Programmahulpbrief* (programme aid letter), which summarised spending in 2003. General budget support increased its stake from €59 million to €86 million (16% of total programme aid and 64% of structural macro-support). Structural budget support in particular increased under this minister. The Netherlands started to enter into multi-year agreements with more and more countries, preferably in a multi-donor context. Co-financing and incidental budget support decreased in importance. In addition to the countries mentioned for 2002 (Burkina Faso, Ghana, Mozambique, Tanzania and Uganda), Benin and Bolivia now received general budget support too. The seven countries had, like other countries that received macro-support in 2003, positive track records (p. 13).

3.2.3.2 The first cracks

Despite rising budgets and an international climate in which the words harmonisation and alignment assumed an increasingly important position, budget support became increasingly politically contested from 2005 onwards. While the initial discussion was about whether countries were meeting their entry criteria, now people were questioning whether countries that received budget support were meeting the criteria for the continuation of support.

The first uncertainties arose with budget support for the old 'donor darling' Uganda. That country started receiving general budget support from the Netherlands in 2002. The support increased substantially in subsequent years, though concerns already existed in 2003 about political developments and the willingness of the Ugandan government to implement reforms. The Netherlands, Ireland and the United Kingdom refused to pay part of the budget support in 2003 in protest against high military spending. The embassy was ordered to make it clear to the Ugandan government that support would end if it strayed further from the path of reform. Support in 2005 would depend on visible improvements, especially in the area of good governance.

Progress in the area of good governance was an important condition for the continuation of (the at that time extensive) budget support, but political developments suggested otherwise. What is more, the Ugandan government, despite threats that budget support would suffer cutbacks, continued to spend more money on defence (TK 2004–2005, 29 234, no. 32, p. 9). In 2005, the Netherlands joined the United Kingdom, Norway and Ireland in sending a political signal by cutting €6 million from the budget support package (€21.8 million in 2004 and €15.9 million in 2005; TK 2004–2005, 25 098, no. 33, p. 4). The amount of €6 million did remain available as emergency aid, especially for projects in the north of Uganda. Eventually, Germany, Sweden and the World Bank also decreased their budget support to the country. The total cutbacks by various countries amounted to US$73 million.[19]

In 2005, the ministry ended budget support to Bolivia, because it lacked a PRSP and had vastly improved its government finances (reducing its budget deficit to 3% of GDP), as well as the instable political situation in the country (see IOB 2006, report 301, p. 91 and the 2006 annual report La Paz embassy).

In April 2006, IOB published a report on the sector-wide approach. This report also focused on general budget support. IOB was, among other things, critical about the way in which the minister had selected the partner countries. In the policy response, the minister indicated that selection was not a scientific process based on purely quantitative analysis, but a *transparent* process in which the minister's own judgement *and* consultation with the House of Representatives had played an important role (TK 2005–2006, 30 548, no. 1, p. 3). The minister also emphasised that essentially all poor countries had weak institutions, and that *therefore* the political will to improve governance was also taken into account.

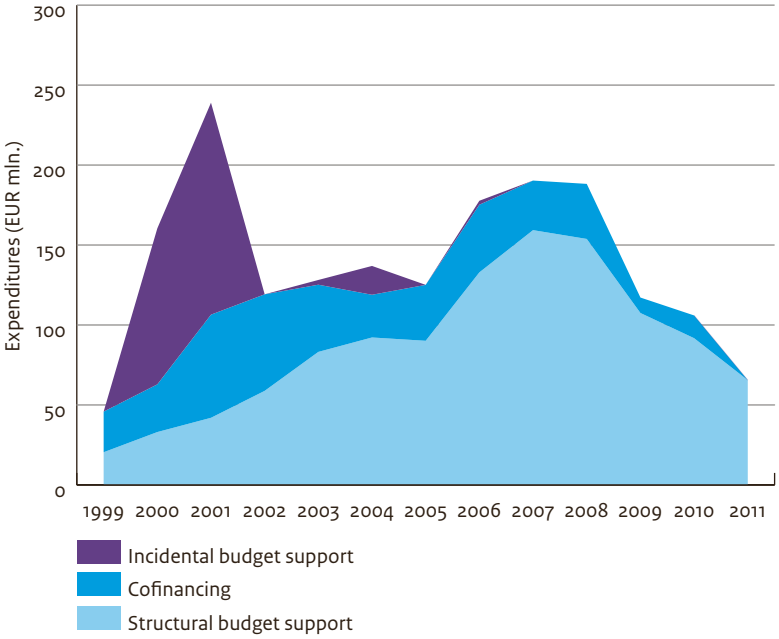
Shortly thereafter, the results of a major international evaluation of general budget support, which involved many donors and various partner countries, were also published (IDD and Associates 2006). The synthesis study summarised the results of seven country assessments: Burkina Faso, Malawi, Mozambique, Nicaragua, Rwanda, Uganda and Vietnam. The synthesis report was generally more positive than the IOB evaluation. The authors concluded that general budget support could be an efficient, effective and sustainable form of aid to support countries in their poverty reduction policies (p. S15). At the same time, they acknowledged that it had been impossible to determine the effects on poverty (p. S7). They did determine that the expectations of budget support had sometimes been too high: budget support does not change political realities (p. S6).

The minister believed these findings backed up her policy (TK 2005–2006, 30 548, no. 2, p. 9). Without specifying this more explicitly, she also indicated that the report gave her reason 'to fine-tune several points of the policy'. In practice, the ministry, in the spirit of

[19] According to the donors, the macro-economic effects would be negligible because Uganda had vast reserves to absorb these cutbacks. At the same time, the minister of foreign affairs and the minister for development cooperation argued in a letter to the House that the cutbacks did have a political impact because they received considerable attention in the media and prompted much political discussion (TK 2005–2006, 891, p. 1889).

the Paris Declaration, worked on further developing the instrument of general budget support. In February 2007, the minister confirmed – right before the new cabinet took office and in response to the report by the Organisation for Economic Co-operation and Development's Development Assistance Committee (OECD/DAC) on the Netherlands' development cooperation policy – the policy on good governance and the role of budget support with improved governance (TK 2006–2007, 30 800 V, no. 68, pp. 2–3).

Figure 3.2: *Development expenditures on general budget support 1999–2011 (EUR million)*



Source: Midas/Pyramid

3.2.4 Minister Koenders (2007–2010): The way back

3.2.4.1 Fine-tuning the political dialogue

Minister Koenders inherited a policy in the spring of 2007 from a minister who had put high stakes on providing general budget support and under whom the most significant growth had been achieved. The new minister, who as a member of parliament had been critical of budget support, including to Uganda, announced that he wanted to be more closely involved in the decision-making process about the use of this modality.

Shortly after taking office, the minister had to deal with the conclusions of an official *Anti-Corruption Task Force*, which, following budgetary approval in 2007, recommended producing sharper analyses of the dimensions of good governance that affect the fight against corruption (i.e. the indicators for voice and accountability, rule of law and corruption).

Based on this analysis, budget support to the following seven countries was open to debate: Armenia, Georgia, Moldova, Mozambique, Tanzania, Uganda and Vietnam. The minister cut in half the budgets for Armenia, Georgia, Uganda and Vietnam (see also TK 2006–2007, 31 061 V, no. 2, p. 3).[20] The year 2007 was the final year of budget support for Armenia, so that it was not clear how this cutback might work as an 'incentive'. The positive income development in Vietnam was also an argument for the minister to decrease support to that country: it was expected that Vietnam would achieve the status of middle-income country in the short term. Koenders initially demanded a 50% cutback for Uganda as well, but eventually he upheld the existing agreements (with a cutback of €6 million). Tanzania, Mozambique and Moldova were on the list too, but in their cases the minister had to agree to continue support based on previously made obligations. Van Ardenne had already linked an increase in budget support to Moldova to improving its track record in the area of good governance and fighting corruption.

The intended budget support to Rwanda and Burundi was at odds with this development. Minister Koenders wanted to give Rwanda budget support because it would enable 'an effective dialogue to be pursued with the Rwandan government about its political objectives and the use of the government budget' (TK 2006–2007, 29 237, no. 61, p. 3). In November 2007, several members of parliament criticised this plan (TK 2007–2008, 29 237, no. 65 and the handling of the Ministry of Foreign Affairs' budget in 2008). Burundi would become the next test case for the budget support instrument. In line with international developments, the new minister wanted to concentrate more on 'fragile states'. With so much attention focused on good governance, this group of countries ran the risk of becoming forgotten states. In the *Een zaak van iedereen* (Our common concern) policy memorandum from October 2007, the minister indicated that the emphasis donors had placed on good governance meant that the countries most in need of the aid most did not receive it, because the conditions for programme aid were lacking (TK 2007–2008, 31 250, no. 1, p. 12). Good governance was therefore no longer the main starting point for aid.

The minister defined three groups of partner countries:

1 *MDG countries*: Low-income countries where fragility was not dominant and government structures offered sufficient prospects for cooperation: Bangladesh, Benin, Bolivia, Burkina Faso, Moldova, Ethiopia, Yemen, Ghana, Kenya, Mali, Mongolia, Mozambique, Nicaragua, Rwanda, Senegal, Tanzania, Uganda, Zambia;
2 *Fragile states*: States where fragility or severe inequality impeded poverty reduction: Afghanistan, Burundi, Colombia, Congo (Democratic Republic), Guatemala, Kosovo (based on Security Council Resolution 1244), Pakistan, Palestinian Territories and Sudan; and
3 *Emerging middle-income countries:* Specifically those with whom the Netherlands maintained '*broad relations*': Egypt, Georgia, Indonesia, Vietnam and Suriname.

Aid to Bosnia and Herzegovina, Eritrea, Sri Lanka, Albania, Armenia, Cape Verde and Macedonia (FYR) would be phased out in the coming four years.

[20] This cutback for Uganda was not immediately clear in the depletion of funds in 2007, because the fiscal year in Uganda runs from 1 July to 30 June. The 2006–2007 tranche (€15.9 million) was paid out in 2007.

In the first group of countries, the Netherlands aimed for substantial financing and active policy dialogue in a limited number of sectors that were important for achieving Millennium Development Goals. The minister also stated his preference for financing by means of the budget, and budget support in particular *because 'it is precisely budget support that creates more financial leeway for better service provision and capacity building in the area of staff and organisation'* (TK 2007–2008, 31 250, no. 1, p. 10).

Under certain circumstances, fragile states could also be eligible for budget support. Moreover, the minister did not consider it realistic to attach budget support to a long list of result indicators in countries with very limited capacity (TK 2007–2008, 29 237, no. 66, p. 10). On the other hand, there would be closer control than was previously the case in countries with better governance. The government also reiterated the importance of good governance for sustainable poverty reduction. With these starting points in mind, in May 2007 the minister granted an amount of €22 million a year for the period 2007–2010 during a roundtable conference in Burundi, which included €10 million for general budget support (with an extra contribution of €4.5 million in 2008). The aid was important for the Burundian government as it enabled them to continue paying the salaries of teachers, doctors and police officers, among others (TK 2006–2007, 29 237, no. 61, p. 3). The expenditures were made by means of a World Bank Trust Fund.

And yet the attention being devoted to fragile states was not something completely new. Burundi already received €8.3 million of stability support from the Netherlands in 2006 (through the World Bank). The (internal) audit department criticised this, however, because Burundi was not a partner country and because the support was not justified by a track record. If there had been a track record, then the country would not have been eligible for budget support. The audit department predicted that in the future budget support would be granted more often to fragile states and therefore recommended that a separate assessment framework be established for this purpose. The audit department also criticised the incidental budget support to Moldova because that country did not meet the conditions either.

What is striking about this discussion is that the ministry viewed the stability support to Burundi as a form of budget support. The only similarity it had with general budget support was essentially that both were forms of macro-oriented aid. Stability support, however, is granted in a completely different context, has a different objective and requires very different conditions (see also chapter 4). An important difference is that it concerns aid to countries where there is insufficient guarantee of macro-economic stability and where there is inadequate capacity to carry out effective poverty reduction policies, including achieving the MDGs within the time limit. The policy and governance conditions were often not met, but that is exactly the crux of the problem. The most important reason to grant macro-support to post-conflict countries like Burundi is to guarantee macro-economic stability and help finance running expenses in order to help the country find calmer political waters again and to prevent conflicts from flaring up again. Evaluation of these forms of aid to, among others, Uganda (late 1980s, early 1990s) and Mozambique (early 1990s) show that

this form of macro-support can be effective to achieve the goals mentioned above (see, for example, White and Dijkstra 2003).

3.2.4.2 The IOB report on Dutch Africa policy

In 2007, IOB had evaluated The Netherlands' Africa policy at the request of the House of Representatives. In early February 2008 the report was published (IOB 2008, report no. 308). It turned out to be, most likely together with developments in a number of countries that received budget support, an important catalyst for a more critical tone vis-à-vis the instrument. That is actually striking, because the IOB report did not divulge any new research results – in fact, it continued to build on the results in the *Joint Evaluation* from 2006. As far as the effects of budget support are concerned, more than anything the report called for more detailed research.

The criticism of the way that the ministry used the instrument was not new either. Following the Court of Audit and the audit department, IOB concluded that a uniform assessment framework was lacking and that the track records could often be interpreted in various ways (see also section 3.4). The report did not call, however, for a more unambiguous and 'scientific' use of the instrument. Rather, it argued that track records should carry less weight: *'It is actually an illusion that something as complex as the assessment of the economic, political, human rights and governance situation in a country, which is in many ways unlike ours, can be evaluated scientifically, as if it were a simple arithmetic sum' (p*. 195). Criticism of budget support allocation focused mainly on the incidental support that the ministry granted Ghana and Mali at the beginning of the millennium to contribute to the peace-keeping forces in Liberia and Sierra Leone (p. 192).[21] Most attention went to the recommendation to use the instrument with *more restraint* in cases of human rights violations, bad governance or insufficient anti-corruption measures (p. 515), a recommendation which the minister had actually already substantiated.

In his response – the policy letter accompanying the report – the minister joined his predecessor, however, in using entry conditions as objectives, which was also the tendency internationally: *'We will not only use budget support as a way of encouraging a dialogue about the responsible use of budgetary resources and the results we wish to achieve with them, but also about more "political" subjects, such as social exclusion, human rights and the quality of governance, including translating national policy into tangible results at the local level'* (TK 2007–2008, 29 237, no. 66, p. 10).

How much empirical evidence pointed to the success of this approach was not raised in the letter.

Although the talks on the IOB report about Africa policy only took place in October 2008, it was discussed much earlier already in debates in House, for example during the General Consultation on the African Great Lakes Region in March 2008 (TK 2007–2008,

[21] Ghana received €80 million in 2001 as balance of payments support; Mali received €18.2 million as incidental budget support.

29 237, no. 171). This showed that the House was much more critical of the instrument than previously and especially towards potential budget support to Uganda, Rwanda and Burundi. In that debate, the minister agreed to inform the House in more detail about the conditions for budget support to these three countries and also to prepare an extensive letter about the instrument. In this letter, dated 22 August (TK 2007–2008, 29 237, no. 74), the minister reiterated what budget support's political function was:

'Budget support is also an important instrument for strengthening and possibly guiding the political development dialogue with recipient governments. More than in the past, I am looking to make this political dialogue more effective, if necessary by personally giving the matter a little boost so we can talk openly and professionally about the lack of results and strategic policy choices that we find important or, more importantly, worrisome ... In the political dialogue, the focus is on increasing the political will to really achieve results ... The political dialogue is also about promoting good governance, ... human rights and democratisation/accountability (counteracting elements of fragility) (p.2) ... I will use budget support more actively an incentive creating political dialogue' (p. 2.).

This letter expresses the minister's confidence – greater than his two predecessors – in the possibility of forcing political change in the policy dialogue and using budget support effectively as an incentive. Budget support's direct function as a contribution to recipient countries' poverty reduction strategies therefore slowly but surely started to make its exit. The decision-making process on Nicaragua was an example. The Netherlands cut its budget support to that country in half after the new government curtailed liberal democratic freedoms.[22] On the other hand, Ortega did do a lot more to fight poverty than his predecessor.

3.2.4.3 A changed climate

By 2009, the climate in the Netherlands regarding this aid instrument had considerably worsened. Various factors played a role in this. On the one hand, the Dutch media had become increasingly critical of development aid in general and budget support in particular. Examples include an interview with Simeon Djankov on 15 May 2008 in *de Volkskrant*, an article in *HP/De Tijd* in August 2008 ('Hulp die niet helpt', or Aid that doesn't aid) and articles by journalist Marcia Luyten in the *NRC* (21 March 2009 and 8 May 2009). More important were the developments in a number of countries receiving budget support. The Netherlands and other donors suspended budget support to Nicaragua after fraudulent municipal elections. In Zambia, the Anti-Corruption Commission reported the misappropriation of US$5 million at the Ministry of Health. The Netherlands and Sweden subsequently suspended aid to that sector. That same year, minister Koenders decided (as the only donor)

[22] This aid to that country had come under pressure earlier because of changes in abortion legislation, which denied women access to abortion on medical grounds (TK 2006–2007, annex to the proceedings 2410; see also Dijkstra and Grigsby 2010 and the case study on budget support in Nicaragua).

to again suspend budget support to Tanzania after business claims by a Dutch businessman had been ignored for years.[23]

Table 3.3: Development of general budget support in 2007–2008

	The Netherlands	Total budget support to the country
Armenia	Halved	Halved in 2005 and then further reduced
Benin	Continued	Increased significantly from 2007 onwards (mainly EU, WB and AfDB)
Burkina Faso	Continued	Increased significantly from 2007 onwards (mainly EU, WB and AfDB)
Burundi	Discussion in House and stopped	Continued, few bilateral donors
Georgia	Halved in 2007	Virtually halved in 2007; €250 million by USA in 2008
Ghana	Increased by 70%	Increases after 2007
Cape Verde	Quadrupled	Continued
Macedonia	Ended in 2006; resumed in 2008	No other bilateral donors
Mali	Continued; suspended in 2012	Continued; suspended in 2012
Moldova	New in 2007 (incidental in 2006); stopped in 2008	No other bilateral donors
Mozambique	Continued; ended in 2012	Strong growth
Nicaragua	Halved in 2008; then ended	Strong decline, from bilateral donors end
Rwanda	Intended general budget support suspended	Does receive budget support (mainly European Commission)
Senegal	GBS postponed due to lack of consultation structure	Increases in 2008, primarily multilateral
Tanzania	Continued after having been suspended for corruption; ended in 2009	Continued, but sharper policy dialogue
Uganda	Halved in 2007; last year of general budget support was 2008	Decreased, but began increasing again in 2009 (mainly DFID)
Vietnam	Halved in 2007 and again in 2008; 2008 last year	Continued. In 2009, Japan contributed a record amount of almost €600 million and France contributed €130 million in 2010.
Zambia	New in 2006, budget support until 2010	Joint MoU in 2006; continued after 2010 except Sweden

[23] Two large-scale corruption scandals were uncovered in late 2007 too: one at the country's central bank and one related to a contract for an oil pipeline and the supply of generators (the Richmond affair). The Netherlands and other donors subsequently suspended budget support to that country. According to donors, the president dealt with the scandals vigorously, after which they disbursed budget support after all in 2008.

Early that year, the minister had decided not to disburse €3 million of budget support to Rwanda because of violations of the weapons embargo against the Democratic Republic of Congo and the Rwandan government's involvement in violence in eastern Congo. There were many reports from Burundi of violations of human rights. In Senegal, poor financial management led to a budgetary crisis, which was cause for the minister to suspend sector budget support to the environment sector.[24] There were suspicions of irregularities in the purchasing of schoolbooks in Uganda, where the Netherlands had already switched from general budget support to sector support. The minister stopped budget support to Macedonia until more clarity could be provided about a macro-economic stabilisation programme. He did the same in Moldova in connection with concerns about the political situation following parliamentary elections in April of that year (TK 2008–2009, 29 237, no. 101). The House of Representatives was especially critical of support to Burundi, however (TK 2008–2009, 29 237, no. 114).

3.2.5 Minister Verhagen (February 2010–October 2010): Continuation of the policy

On 20 February 2010, the Balkenende IV cabinet fell after deliberations about the military mission in Uruzgan, Afghanistan. The Labour Party ministers submitted their resignations, and the remaining ministers from the Christian Democratic Appeal and the ChristianUnion surrendered their portfolios. This meant the Minister of Foreign Affairs Maxime Verhagen would take over the development cooperation portfolio until the Rutte cabinet took office. The minister announced that he would continue the budget support policy of the outgoing Minister for Development Cooperation. He did, however, limit his own immediate interference in budget support to Burundi, Tanzania and Uganda.

The discussion about the provision of budget support to Burundi and Rwanda persisted, but the minister indicated that decision making about continuing or resuming budget support would only take place in the autumn of 2010. The focus at the time had already shifted to the budget support that the European Commission was providing to a number of developing countries. In some cases, the much more extensive budget support from the European Commission seemed at complete odds with Dutch policy. A second reason why budget support received less attention was the publication of the report by the Scientific Council for Government Policy (WRR), *Less Pretension, More Ambition*. This report criticised Dutch development cooperation, but it barely commented on the instrument of budget support. The WRR viewed it primarily as an instrument to prevent fragmentation (WRR 2010, p. 129). The WRR also challenged the position that threatening to end budget support would be effective:

[24] The IMF representative in would also have received two suitcases with US$ 100,000 and US$ 50,000 from Prime Minister Souleymane Ndéné (Handelingen TK 26-2309, November 2009).

'Withdrawing aid has proven a poor sanctioning instrument ... All these sanctions were a result of Dutch national politics, and had nothing to do with foreign policy. In fact, such politically correct interventions undermine the negotiating position of the Netherlands in the country itself and hamper the process of setting out a long-term development strategy. Their small scale alone means they have no effect on the recipient countries. Six decades of development aid have shown that there is little point imposing ex-post conditionalities and that sanctions of this scale, imposed retroactively, have little effect' (WRR 2010, p. 137).

3.2.6 Minister Knapen (October 2010– 2012): Greater selectivity

The radically changing climate regarding development cooperation found expression in the formation of a new cabinet after the fall of the Balkenende IV cabinet. The new cabinet drastically cut development cooperation (by a total of €0.9 billion in 2012). Budget support was immediately targeted as easy pickings. The cabinet shifted attention from governments to the private sector in what it called an innovation of the development policy. Although the WRR report did serve as a guiding principle in this, the involved parties were also quick to agree on setting stricter demands on the budget support instrument. The coalition agreement stated that '*budget support will not be granted if there is any hint of corruption, violation of human rights or insufficient good governance*' (p. 8).

This starting point was not new in theory, but it would be much more closely adhered to than in previous years. In the past, countries were eligible for budget support providing they demonstrated the 'intention' to improve governance. The *Basisbrief Ontwikkelingssamenwerking* (Letter to the House of Representatives outlining development cooperation policy) in November 2010 revealed the first outlines of how the ODA budget would be cut (TK 2010–2011, 32 500 V, no. 15). The new policy's main points were selectivity (limitation of four thematic spearheads), mobilisation of the private sector and a considerable reduction of the number of partner countries (see table 3.4). This reduction also had consequences for (general) budget support. It meant a reduction of 34% (€44 million of an estimated amount of €128 million; see also figure 3.3) just in the year 2011.

Table 3.4: Partner countries before and after 2011

		Partner countries Verhagen / Koenders		
		MDG countries	Fragile states	Emerging middle-income countries
Partner countries Rosenthal / Knapen	MDG countries	Benin, Ethiopia, Mali, Mozambique, Uganda, Rwanda		
	Fragile states	Yemen	Afghanistan, Burundi, Palestinian Territories, Sudan	
	Emerging middle-income countries	Bangladesh, Ghana, Kenya,		Indonesia
	Termination of bilateral relationship	Bolivia, Burkina Faso, Moldova, Mongolia, Nicaragua, Senegal, Tanzania, Zambia	Colombia, Congo (DCR), Guatemala, Kosovo, Pakistan	Egypt, Georgia, Vietnam, Suriname

As part of the new policy, the ministry made an extensive and systematic assessment in late 2010 of the countries to which the Netherlands would stop giving budget support. The ministry based their selection on the following:

1 developments in the quality of governance;
2 the development of human rights in the country;
3 socio-economic developments and progress in achieving the MDGs; and
4 commitments that have been taken on.

The scan of the first two elements (what is referred to as the 'first gateway') was both quantitative and qualitative; the scan of the second gateway was mainly qualitative. Table 3.5 summarises the assessments.

Table 3.5: Evaluation of continuing budget support

	Benin	Burkina Faso	Ghana	Mali	Mozam-bique	Senegal	Tanzania	Uganda	Zambia
First gateway:									
Kaufmann score	-1.4	-1.9	0.8	-2.4	-0.4	-2.0	-1.7	-3.7	-1.9
CPIA*	9.5	10.5	11.0	10.0	9.0	10.0	10.0	8.5	9.0
PFM score	7.0	8.0	8.0	7.0	8.0	7.0	7.5	7.5	7.0
Human rights**	3	7	2	4	6	5	6	8	6
Average income (GDP per capita of the population in US$)	749	536	1,325	602	410	1,034	524	509	1,253
Overall judgement of track record***	B	B+	B-	B--	B-	B-	B-	B	B-
Second gateway:									
MDG progress	2.9	5.0	5.0	4.0	3.0	3.0	1.1	5.0	2.0
Economic growth 1996–2008 (per capita)	1.3	2.8	2.6	2.5	5.3	1.4	3.0	3.8	1.8
Business climate (rank)	170	151	67	153	126	152	128	122	76
Aid dependency (ODA/GDP), 2005–2008	13%	17%	17%	20%	25%	14%	19%	22%	19%
Independent income (% GDP)	19%	13%	21%	14%	15%	19%	15%	12%	17%

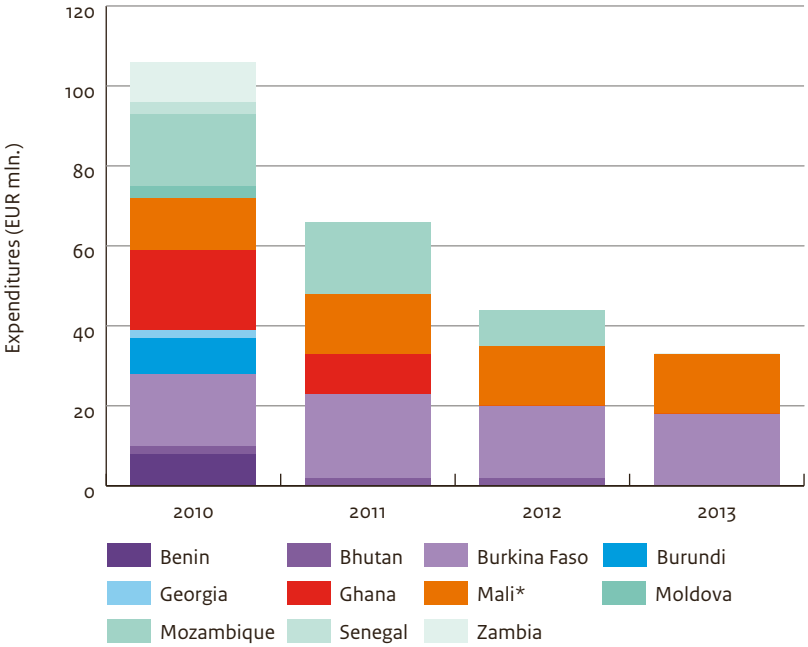
* *This is the added-up score of 3 IRAI indicators (D12, D15 and D16).*
** *Freedom House indicator.*
*** *Assessment by the embassy.*

Ghana came out on top in the first gateway. This country would be removed from the list because of its income development: Ghana had reached the status of lower middle-income country and was expected to benefit from oil income in the coming years. Uganda scored poorly on most of the governance parts, though the country did conspicuously well in the track record.

Mozambique, Burkina Faso and to a lesser degree Zambia qualified for the 'second gateway'. The other countries had lower scores. Based on this first scan, the ministry conducted a second, more qualitative analysis later on, on the basis of which it was decided to continue giving budget support only to Mali. In 2012 Burkina Faso, Bhutan and Mozambique would also receive budget support. For Mozambique and Bhutan, 2012 is the last year, and for Burkina Faso it is 2013, when the embassy in Ouagadougou plans to shut its doors.

The minister also suspended support to Mali in April 2012 following a military coup in that country.

Figure 3.3: *Expenditures on general budget support 2010–2011 and estimated expenditures 2012–2013**



* *No commitments yet for Mali for 2013.*

Despite careful analysis based on a limited number of indicators, decision making continued to be based on other considerations. Considerations to do with good governance were the deciding factor in this process, apart from the question of whether good governance is a condition for poverty reduction or whether it is possible to improve governance with budget support. The latter consideration – to let the continuation of support depend on existing commitments – was highly pragmatic, to say the least. It thwarted a more principled decision-making process.

3.2.7 The discussion with the European Commission

As was the case with bilateral donors, the European Commission had also put its money on budget support in the first decade of the millennium. According to figures from the OECD/DAC database, expenditures had risen from more than €325 million in 2002 to €650 million in 2008. This meant that the Commission had become of the most important providers of this modality.

In 2008, the European Commissioner for Development and Humanitarian Aid, Louis Michel, published a report on budget support, in which he indicated that he intended to raise the share of general or sector budget support in ACP country programmes of the European Development Fund (EDF) from 12% to 50%. This is in line with the agreements made in Paris (2005) and Accra (2008), as well as the demands and policy of the member states. For the 10th EDF (for the period 2008–2013), the Commission wanted to provide approximately €5.5 billion through general and sector budget support (about 25% of the Fund's resources). Seven African countries would receive a part (a total of €1.6 billion) in the form of multi-year MDG contracts, in order to support these countries to achieve the MDGs. The Commission also made a sum available for what was referred to as the *Governance Incentive Tranche*, which was meant to encourage countries to carry out improvements in the area of governance as well. In line with these developments, the Commission's expenditures on budget support increased to €1.3 billion in 2010.

Meanwhile, little by little opinions on the application of budget support began to diverge. Whereas donors in the Netherlands and Germany gradually became more critical of the minimum requirements that were being set for good governance, the Commission held on to the original objectives of poverty reduction and helping countries achieve the MDGs (De Kemp, Leiderer and Ruben 2011). Committing partner countries to reforms was more important to the Commission than adhering to minimum standards of good governance. The growing differences became evident during discussions about budget support to Nicaragua in 2008 and Rwanda in 2009. That year, the European Commission increased sector support to the health sector in Zambia, after the Netherlands and Sweden had suspended it because of a corruption scandal.

The growing criticism of the instrument in its own country had an important impact on the position of the Dutch government. The greater selectivity in the Netherlands conflicted with a considerable expansion of the instrument by the European Commission. Both in the Netherlands and internationally, Minister Koenders argued for a strengthening of the political dialogue on budget support. In 2008, he proposed, in a European context, that the European Commissioner for Development and Humanitarian Aid, together with involved member states, send an annual letter to the government of the recipient country containing the main points of the policy dialogue. During the Czech presidency of the European Union, in the first half of 2009, the Netherlands requested again that a political debate be held about strengthening the policy dialogue on budget support and good governance. The Ministry of Foreign Affairs prepared a discussion paper for that purpose, which emphasised the necessity of a joint response should political problems arise. Gradually, the Netherlands received support for this initiative from several other countries, such as Germany, Sweden, Denmark and Ireland. In November 2009, the Commission responded with a non-paper, which followed the tenets of the Cotonou Agreement. This Agreement stated that the provision of budget support must be based on sufficiently transparent governing aimed at accountability and effective financial support, and on agreement about macro-economic or sector policy. According to the European Commission, this position ruled out the criteria for providing and continuing support desired by the Netherlands. This subsequently led to a response by the Netherlands in April 2010 in the form of an 'issue paper', a final version

of which was completed in October 2011. In this paper, the Netherlands emphasised the necessity of a joint approach in case of crisis situations.

Earlier, the Netherlands had also requested a Green Paper and Communication from the Commission as a basis for a joint approach. This Green Paper appeared in October 2011 as well. It aimed to collect opinions and experiences regarding budget support, in order to improve the instrument's use. As a basis for the discussion, the Green Paper raised a number of questions, as a result of which the policy and political dialogue were put in the limelight. Moreover, the Commission also asked whether budget support needed to become dependent on the quality of political governance.

The Green Paper provoked many responses, not only from member states, but also from NGOs and the academic world.[25] The new (Dutch) cabinet criticised the Commission's technocratic and legalistic position. According to the Netherlands, the Commission should, in consultation with member states, evaluate more strictly whether recipient countries still met the basic conditions for good governance, human rights and anti-corruption measures. The cabinet demanded that the Commission would show more restraint in their provision of budget support. The Commission should not use this modality in cases where member states, such as the Netherlands, had reached a negative judgement about the quality of governance, human rights or the fight against corruption. The Commission should also, together with member states, encourage a more active political dialogue about these subjects.

The Green Paper and the discussions of it eventually resulted in a *Communication* from the Commission in October 2011 (COM(2011) 638). The European Commission and member states did not disagree on the necessity of increased coordination in the area of budget support. But while this meant for member states such as the Netherlands that the Commission would not be able to deviate from the view of individual member states, the Commission viewed this primarily as a strengthening of its own coordinating function. Nonetheless, the Commission gave in to the Netherlands by taking, more than in the past, good governance and respecting human rights as the starting points for budget support:

'The new approach should strengthen the contractual partnership on EU budget support between the EU and partner countries in order to build and consolidate democracies, pursue sustainable economic growth and eradicate poverty ... Therefore, general budget support should be provided where there is trust and confidence that aid will be spent pursuing the values and objectives to which the EU subscribes, and on which partner countries commit to move towards meeting international standards ... In order to better reflect these fundamental changes, EU general budget support should be referred to in future as "Good governance and development contracts".'

This approach would, according to the Communication, make EU budget support more efficient and effective at delivering development results.

[25] NGOs and academics were generally more positive about budget support than the Dutch cabinet.

Nevertheless, the Dutch secretary of state still believed that the entry test for the provision of budget support was too lenient. This would result in budget support remaining too large a part of the European Development Fund (TK 2011–2012, 22 112, no. 131, p. 5).

It is telling in the discussion that bilateral donors such as the Netherlands and Germany increasingly abandoned their original policy theories and objectives in the course of the years, while the 'technocratic' approach of the World Bank and the European Commission remained closer to the original (Faust et al., 2012, pp. 2–3). Faust et al. conclude that while the new approach may be more politically oriented, it did not have a clear strategy about the way in which budget support could contribute to the intended political changes and democratisation. There was some evidence that a *harmonised* approach is more effective than a fragmented response by donors in conflict situations, but that is still something different than the effectiveness of budget support, and especially of the political dialogue, as instruments for political change. Faust et al. argue that the new approach of greater selectivity entails the risk of losing the main mechanism for high level policy dialogue and therefore an important instrument in the contribution to a country's overall reform process (p. 5). The researchers have more faith in the policy dialogue than in conditionality, but here too it is not clear how effective such an approach would be (see also chapter 5). Budget support is easily seen – whether intentionally or unintentionally – as a government's support, and so it also has a political function. There could be political reasons not to provide budget support. Over-politicisation of the instrument, however, could have a negative impact on attempts to bring the original objectives closer together – poverty reduction and achieving the MDGs.

3.3 Policy reconstruction

Dutch policy developments dovetailed closely with the changes in international thinking about aid effectiveness. The World Bank report *Assessing Aid* from 1998 already suggested that aid could only be effective in countries with good policy. Many donors concluded from this not only that aid should be limited to these countries (compare the Dutch partner countries), but also that precisely these countries should be given more ownership over their development and that aid should dovetail with national programmes. Programme aid was therefore the most logical modality. At the *High Level Forum* in Rome in 2003, donors and developing countries agreed that development aid would be given in line with the partner countries' priorities (alignment) and that donors would harmonise their aid.

Two years later, they went further with the *Paris Declaration*. There were five key elements in the declaration:

- *ownership*: developing countries set their own strategies for poverty reduction, improve their institutions and tackle corruption;
- *alignment*: donor countries align behind these objectives and use local systems;
- *harmonisation*: donor countries coordinate, simplify procedures and share information to avoid duplication;

- *results*: developing countries and donors shift focus to development results and measuring results; and
- *mutual accountability*: donors and partners are both accountable for development results.

Donors obliged themselves to deploy at least 66% of their aid through 'programme-based approaches', and at least 50% of bilateral aid through the partner counties' systems.

The policy was not based on any detailed policy theory, however. The rationale for budget support was more detailed than the intervention logic, while the primary objective, supporting recipient governments' poverty reduction and reform policies, often remained implicit (TK 2008–2009, 29 237, no. 101, p. 3).

Programme aid gave minister Pronk the opportunity to let the development cooperation budget grow despite absorption problems with project aid. He did set a number of conditions for it:

1 the socio-economic policy in the country that stands to receive the aid should be in line with Dutch starting points, and
2 the country in question should also have the institutional capacity for it.[26]

Sector budget support was still the most important concern for minister Pronk at the time. That was also true, though to a lesser degree, for minister Herfkens, under whom the sectorwide approach started to develop. She too mentioned good governance as a condition for both the selection of partner countries and the provision of programme aid, in line with the conclusions of the *Assessing Aid* report. However, the minister did not use good governance as an absolute selection criterion, but she introduced – whether implicitly or not – the idea that programme aid could also be an effective means of promoting good governance (see also chapter 2).

This shift in thinking about good governance was further solidified by minister Van Ardennne, under whom the *intention of good governance* became the basis for budget support. As a result, the old conditionalities took on added significance in the policy dialogue and political dialogue, where budget support received a dual function of being a financing instrument and a financial stimulus.

Linking budget support to the 'intention of good governance' became the instrument's Achilles heel. On the one hand, conditions without a clear change in the policy theory became objectives, but that gave budget support a dual objective: both poverty reduction and improved governance. Budget support therefore began to serve different objectives, though their hierarchy was not clear:

[26] These conditions were not new, incidentally. They concurred with the results of a study on import support by IOB's predecessor, the Inspectie Ontwikkelingssamenwerking te Velde (IOV, 1989). IOV argued that import support could be an effective instrument, *providing* a) the recipient country was carrying out good socio-economic policy, and b) the country also had sufficient implementation capacity. The report concluded that if these conditions were met, then in principle import support would need as little guidance as possible. Conversely, import support would have little effect as an instrument to correct socio-economic policy, according to IOV.

'Budget support is granted on the condition that effective poverty reduction strategies reflect national priorities, with good macro-economic policy, transparent government finances and good governance. This is how budget support can contribute to economic growth, and because it is linked to poverty reduction strategies, it contributes to the reduction of income inequality (TK 2009–2010, 31 250, no. 72, p. 18–19).

This lack of clarity, and the absence of clear intervention logic, also complicated the establishment of distinct rules about the use of the instrument. According to the internal auditor, the ministry's guidelines did not demonstrate sufficiently what was acceptable or not, nor which improvements should be achieved and when. If there were delays in carrying out the agreed upon policy in countries that received budget support, should the Netherlands remain a reliable partner and continue giving budget support, or should the Netherlands attach immediate financial consequences to the failure to produce results? In essence, this was a problem that policy theory had barely given any attention to.

Moreover, bilateral donors were not pushing recipient governments to take immediate action, but focused on outcome and impact indicators, over which recipient governments did not always have direct influence (see also chapter 5). In addition to these results indicators, they therefore also needed a number of underlying principles, which recipient governments had to live by:

'The underlying principles of budget support are to be found in the areas of democratic governance, respect for human rights and international rule of law, macro-economic stability, commitment to poverty reduction, principles of good governance and good financial management ... The underlying principles also function as an emergency-brake clause that donors can fall back on when these principles are flagrantly violated ... Calling recipient governments to account on the underlying principles is a serious measure and will be used with restraint.'
(TK 2008–2009, 29 237, no. 101, p. 5).

The ministry assessed the provision or continuation of budget support on the basis of track records (see next section), whereas progress on the Performance Assessment Framework played an important role in the MoU. In practice, it was mainly a rift with one of the underlying principles that led to the suspension or termination of budget support. At the same time, underlying principles occasionally turned out to be objectives: *'Some of the underlying principles end up in the agreement about projected results ... especially when it concerns poverty reduction, good governance and good financial management'* (ibid, p. 5).

Not only was the internal audit department critical of these kinds of flexible interpretations, so was the Anti-Corruption Task Force (2007). The task force's report, which already hinted at a changed climate, contributed to minister Koenders' stricter interpretation of good governance. Fiduciary risks and the fight against corruption took on increasing significance in this new climate, at the expense the original objectives. Although the minister considered calling recipient governments to account a serious measure that should be used with restraint, he did resort to this within two years with the majority of countries that received budget support: Uganda, Tanzania, Rwanda, Nicaragua, Armenia, Georgia, Vietnam, Macedonia and Moldova.

The minister did want to give budget support to Burundi, on the other hand, despite the fact that it did not meet the requirements in any way whatsoever. The minister failed to distinguish this (stability) support clearly enough from budget support to other countries. He did indicate that the aid to Burundi mainly served to defray the cost of running expenses and therefore promote stability. However, by incorporating the country in a letter on budget support to the House of Representatives, without a clear cut-off point, he gave the impression that it concerned a marginal difference here. This resulted in the House asking itself why the Netherlands suspended budget support to Tanzania, for example, but not to Burundi. In terms of content, the aid to Burundi showed more similarities to that given to Afghanistan or Ramallah, or that given to Uganda or Mozambique 20 years ago.

The second of Pronk's conditions – a sufficient implementation capacity in the partner countries – was actually never further elaborated. That was hardly surprising in light of all the attention on alignment and ownership, but here too condition and objective become blurred. It was not rare for partner countries to indicate that they needed technical assistance more urgently than financial aid. Minister Herfkens wanted to cut back this modality as soon as possible. In addition, a great deal of the technical assistance that was deployed was uncoordinated and supply driven (see IOB 2006, p. 137; IOB 2008, p. 53; De Kemp, Faust and Leiderer, 2011). Koeberle and Stavreski (2006, p. 19) also asked whether donors themselves possessed the technical capacity to effectively design this modality, which required completely new kinds of expertise. Policy advisors at the embassies needed to have more and more knowledge of financial management, and the ability to evaluate financial systems and estimate financial risk. The Netherlands therefore set up internal courses for this purpose in 2003, and developed a 'guide' to analyse and evaluate the setting up, implementation and accountability of budgeting and external auditing. But the question remains whether the development of some basic skills was not being confused with the required financial expertise. Partner countries have also learned how to hit the capacity ball back over the net and complain about the short-lived embassy staff's lack of expertise (see Lawson et al. 2011).

3.4 Implementation

3.4.1 Basic principles and conditions

The basic principles implied an assessment framework that the ministry could use for decisions about the provision of budget support. At the same time, establishing an unambiguous framework was by no means an easy task, because in a specific situation the transition to budget support was the result of international deliberation, which sometimes involved many actors. This was also evident in the fact that budget support frequently came about when countries, influenced by debt relief initiatives, set up their own poverty reduction strategy. On the other hand, in practice programme aid was an extremely flexible instrument, which made it possible to spend large amounts at the end of the year in order to exhaust the budget and meet international agreements. Precisely this flexibility required a framework to prevent programme aid, including budget support, from becoming infused with overly pragmatic input considerations. The IOB (IOV) already concluded in 1989 that there was a serious risk that under these circumstances aid would be ineffective.

In 1994, the Dutch Court of Audit criticised the lack of a concrete assessment framework for programme aid (TK 1994–1995, 24 045, nos. 1–2). The main concern, incidentally, was to assess the conditions for import support, which was by far the most important form of programme aid during research period (1988–1993). Partly in response to this, the minister presented a framework and a *Programme Aid Manual* that year, which became obligatory in 1996. The introduction of *macro-exercises* that year made it possible to conduct more systematic and comprehensive assessment of proposals for macro-support.

Partly influenced by the results of a follow-up study by the Court of Audit, the minister sent a memorandum on macro-oriented programme aid (the *Notitie Macro-georiënteerde programmahulp*) to the House of Representatives (TK 1999–2000, 26 433, no. 22). This memorandum contained an assessment framework with four clusters and eight aspects (see also section 3.5). In the following years, the ministry further elaborated the memorandum with new, internal memorandums and manuals.[27] The point of departure for providing budget support was the *track record* put together by the embassies. They combined their own analysis with those of the IMF and the World Bank, such as the World Bank's Country Policy and Institutional Assessments (CPIA). Embassies had to explain deviating scores.[28]

Although the assessment framework was mainly used for selection, the minister also left room for *ex ante* criteria by also incorporating the *expected* progress in the track record. The minister would set priorities for macro-support to the various countries based on the following:

1 IDA eligibility (relative poverty and access to the international capital market);
2 debt situation and financing gap;

[27] Including the 2001 memorandum on the relationship between macro-oriented aid and sector programme support, the guidelines for assessing assessment macro-support, the Poverty Strategy Paper (PRSP) guide and the Public Finance Management (PFM) appreciation framework from 2002.

[28] In practice, the embassies were more critical than the World Bank.

3 net ODA flow; and
4 continuity in Dutch policy.

The minister did not give any weight to these factors. The point was to come to an overall assessment based on these criteria.

In 2003, *PFM appreciation*, in addition to track record, was part of the assessment process of a country eligible for budget support. The objective of the PFM appreciation was to have a better understanding of the budgetary policy and management, based on:

- Medium-Term Expenditure Framework (MTEF);
- Public Expenditure Review (PER);
- Country Financial Accountability Assessment (CFAA); and
- National Court of Audit reports.
- A good appreciation in the PFM framework was a condition for budget support.

An adjustment was made to the framework in 2004, which integrated PFM and the business climate into the framework. The framework now consisted of the following clusters:

a poverty reduction;
b economic organisation;
c good governance; and
d policy dialogue.

In the second half of 2006, the ministry decided to 'delegate' the resources for general budget support to the embassies. The ministry in The Hague, however, retained responsibility for the final assessment. This is what the procedure for providing budget support looked like at the time:

1 the embassy put together an annual track record as part of the multi-year strategic plan MYSP annual plan. Based on that, the embassy made a proposal on how to use the aid modalities;
2 if the track record was unsatisfactory, the minister had final say if the embassy wanted to provide budget support;
3 the embassy received the budgets with the approval of the MYSP or the annual plan;
4 the embassy prepared an assessment memorandum for new obligations ; and
5 the embassy reported every year by means of the annual plan/MYSP.

The embassy and the ministry were to determine the size of budget support based on the development of trends, the policy dialogue, the partner country's budget deficit and Dutch country allocation. The reality was much less manageable than this simple procedure suggests, however. Budgetary considerations, political developments in partner countries, as well as domestic political factors all ended up playing a more important part in the process.

Over the years, the ministry thus continued to refine their guidelines for the use of budget support, in part influenced by the audit department and the Court of Audit, while decisions about the provision of budget support (or its termination) were often taken in an international context and on grounds of concrete political considerations. So it would seem

obvious to also base the concrete use of the instrument on a political decision (something that minister Koenders considered). IOB concluded in 2008 in the Africa evaluation that it was an illusion to think one could evaluate the economic, political, human rights and governance situation in a country as if it was a simple arithmetic sum (p. 195). There is an example that elucidates this. In 2010, Zambia 'scored' 100% on the education indicators in the Performance Assessment Framework for general budget support. In that same year, education donors decided to suspend sector support because the ministry was showing barely any commitment to carry out what were considered necessary reforms in the area of financial management. The suspension of budget support to Tanzania in 2008 is also difficult to defend based on this framework. This measure was not understood internationally either.

3.4.2 Financial development 2000–2011

The structural use of general budget support started to gradually pick up at the beginning of the new millennium. The minister provided mainly incidental budget support in 2000 and 2001, thanks in part to the fortuitous development of the development cooperation budget (due to its linking to the GDP). Until 2003, a large part of budget support went through the World Bank (co-financing). In total, eleven countries received structural and incidental macro-support that year (excluding debt relief) for a total sum of € 128 million, of which €42 million through the World Bank (see table 3.6).

Budget support gained importance from 2003 onwards, in part because of the development of the budget for development cooperation. In the course of 2006, the ministry asked its embassies to draft proposals to structurally expand the budget support being given to several countries. A total budget of €40 million was 'available' for this. In essence, national and international input objectives provoked a more flexible approach and a more lenient assessment. The ministry spent a total of €178 million in 2006 on general budget support, as opposed to €125 in 2005. The next two years would be 'top years' as well for budget support, though the total would never exceed €190 million. In 2008, Bhutan, Senegal and Macedonia also received budget support, lifting the number of recipient countries to its climax.

Things went downhill after that. In 2009, budget support to Cape Verde, Nicaragua, Tanzania, Uganda and Vietnam was terminated. The following year was still stable, but in 2011 expenditures fell to €66 million. Benin, Burundi and Zambia, for example, no longer received budget support that year.

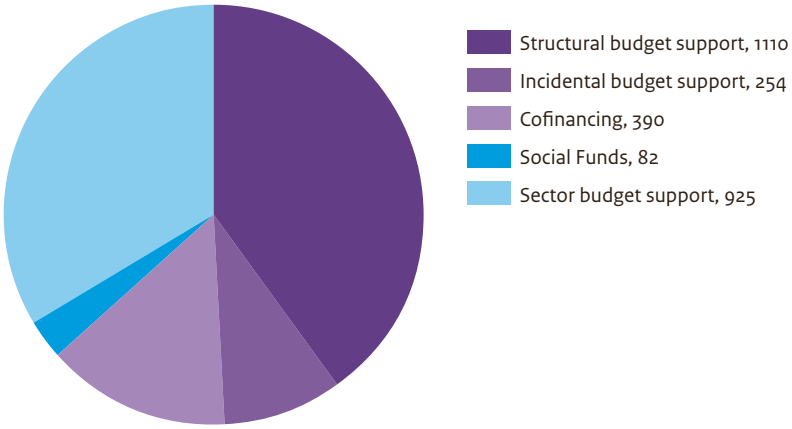
Table 3.6: Expenditures on budget support 2000–2011*												
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Expenditures (x EUR 1 million for 31 countries)												
Structural GBS	33	42	59	83	92	90	133	159	154	108	92	66
Co-financing	30	64	60	42	27	35	42	31	34	10	14	
Incidental GBS	98	133		3	18		3					
Debt relief	107	150	159	90	7	76	5	2		35		
Sector support	146	189	171	129	182	173	234	283	334	317	280	241
Other bilateral	377	344	404	351	328	417	435	486	465	450	379	343
Total	**790**	**922**	**854**	**698**	**654**	**791**	**852**	**961**	**988**	**920**	**765**	**649**
As percentage of the total (for 31 countries):												
Structural GBS	4.2	4.6	6.9	11.9	14.1	11.4	15.6	16.6	15.6	11.7	12.0	10.1
Co-financing	3.8	7.0	7.1	6.0	4.1	4.4	5.0	3.2	3.5	1.1	1.9	
Incidental GBS	12.3	14.4		0.4	2.8		0.3					
Debt relief	13.5	16.3	18.7	12.8	1.1	9.6	0.5	0.2		3.8		
Sector support	18.4	20.5	20.1	18.5	27.9	21.9	27.5	29.4	33.9	34.5	36.6	37.1
Other bilateral	47.7	37.3	47.3	50.3	50.1	52.7	51.1	50.6	47.1	49.0	49.6	52.8
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
ODA Total (EUR million)	**3,513**	**3,772**	**3,828**	**3,816**	**3,948**	**4,231**	**4,692**	**4,824**	**5,049**	**4,728**	**4,877**	**4,624**
As percentage of total ODA:												
Total macro**	4.6	6.3	3.1	3.4	3.5	3.0	3.8	3.9	3.7	2.5	2.2	1.4
Sector support	4.1	5.0	4.5	3.4	4.6	4.1	5.0	5.9	6.6	6.7	5.7	5.2
Total 31 countries	**22.5**	**24.4**	**22.3**	**18.3**	**16.6**	**18.7**	**18.2**	**19.9**	**19.6**	**19.4**	**15.7**	**14.0**

* *For 31 countries that received general and/or sector budget support between 2000 and 2011: Armenia, Bangladesh, Benin, Bhutan, Bolivia, Burkina Faso, Burundi, Cape Verde, Colombia, Georgia, Ghana, India, Indonesia, Kenya, Kyrgyzstan, Macedonia, Mali, Moldova, Mozambique, Nicaragua, Palestinian Territories, Rwanda, Senegal, South Africa, Sri Lanka, Suriname, Tanzania, Uganda, Vietnam, Yemen and Zambia.*

** *Excluding debt relief.*

The high attention suggests otherwise, but between 2002 and 2011 general budget support always amounted to less than 4% of the total Dutch ODA expenditure. The total only exceeded this in 2000 and 2001 due to extensive incidental budget support. In addition to this, the ministry did strengthen sector budget support. The total amount is more difficult to determine because the definition was not always unambiguously applied, and the boundaries of earmarked basket funding for a sector are vague sometimes. For example, between 2000 and 2004, €82 million went through multilateral social funds. Sector budget support amounted to a total of approximately €925 million.[29] The total then comes to about €2.7 billion, 5.3% of total ODA for the period 2000–2010 (see figure 3.4).

Figure 3.4: *Total budget support by type (2000–2011; EUR mln.)*

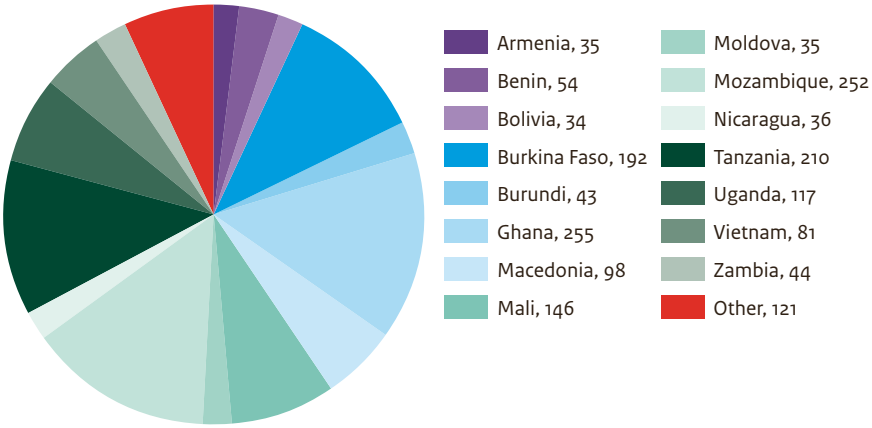


Source: Midas/Pyramid; adapted by IOB

A total of 23 countries received general budget support (including incidental and co-financing) between 2000 and 2011 for a total amount of €1.75 billion. The most important recipients (in financial terms) were Ghana, Mozambique, Tanzania, Burkina Faso, Mali and Uganda (see figure 3.5).

[29] Table 3.6 also includes the totals for basket funding for sector support (a total of €172 million).

Figure 3.5: *Total general budget support by recipient (2000–2011; EUR mln.)*



Source: Midas/Pyramid; adapted by IOB

3.4.3 Administration

The focus on budget support gradually shifted from entry conditions to fiduciary risks, which were political risks for the minister, as financial scandals were uncovered in several countries and as criticism began to mount. The paradox here is that corruption scandals were presumably also an expression of improved financial management and better auditing in partner countries. If anything, the various corruption indices pointed to progress rather than decline.

In 2009 and 2010, the Financial Department of the ministry conducted a study on the quality of administration of budget support in six countries, partly to offset risk factors.[30]

The department concluded that the administrative tools did not dovetail well with the decision-making process. It cited Nicaragua and Rwanda as examples. According to the track record, these countries should have been eligible for a continuation of budget support, whereas other considerations had led the minister to terminate it. The department also concluded that the situation in Uganda and Burundi was exactly the opposite. The track record did not permit budget support in those countries.

[30] These six countries were Nicaragua, Rwanda, Senegal, Tanzania, Uganda and Zambia.

3.5 Characteristics of recipient countries

3.5.1 Introduction

As figure 3.5 already showed, it was mainly partner countries that were eligible for budget support, though there were some exceptions (Bhutan and Kyrgyzstan). The instrument was closely linked to the HIPC initiative (see also chapter 4). Countries that received direct structural budget support were mainly countries that also received debt relief in the framework of this initiative and therefore also prepared a *Poverty Reduction Strategy Paper* (PRSP). Cape Verde and Bhutan were the only exceptions. Bolivia received the most budget support through the co-financing of World Bank programmes, though the Netherlands also gave direct budget support to that country. Countries without debt relief via the HIPC initiative received budget support through the World Bank, or only incidental support (Yemen and the Palestinian Territories). Of the other countries, only Ethiopia and Rwanda were eligible for debt relief through the HIPC initiative (see table 3.7).

The comparisons in this section are twofold. First, the analysis focuses on differences in partner countries' *track records*, with a distinction between countries that did or did not received budget support from the Netherlands. In order to get a more complete picture, we also examined several other characteristics that played a part in the assessment but which were not selection criteria. This analysis is not about determining whether the assessment criteria were applied well or not, but much more about discovering what the difference between these two groups of countries are and whether these differences generally dovetail with the starting points for and the intended effects of budget support.

The analysis focuses on the 36 partner countries determined by minister Van Ardenne, supplemented by three countries that also received budget support during this period: Bhutan, Burundi and Kyrgyzstan.[31] By and large, this list corresponds to with the list of partner countries under other ministers. The comparison focuses on 2003 and 2007. IOB chose 2003 because that was actually the first year that general budget support got a more structural form. The highest expenditures were in the years 2007/2008, when the minister had not yet taken many measures to limit support to a number of countries. In 2003, eleven of these countries received budget support. In 2007 there were fifteen.

[31] The full list thus included: Afghanistan, Albania, Armenia, Bangladesh, Benin, Bhutan, Bolivia, Bosnia and Herzegovina, Burkina Faso, Burundi, Cape Verde, Colombia, Egypt, Eritrea, Ethiopia, Georgia, Ghana, Guatemala, Indonesia, Kenya, Kyrgyzstan, Macedonia, Mali, Moldova, Mongolia, Mozambique, Nicaragua, Pakistan, Palestinian Territories, Rwanda, Senegal, South Africa, Sri Lanka, Suriname, Tanzania, Uganda, Vietnam, Yemen and Zambia.

Table 3.7: Characteristics of countries that received budget support

	Dominant form	First year budget support	HIPC Decision Point	PRSP completed	IMF agreement	
					2003	2007
Bolivia	Co-financing	1999	2000	2001	Yes	Yes
Armenia	Co-financing	1999		2003	Yes	Yes
Georgia	Co-financing	1999		2003	Yes	Yes
Kyrgyzstan	Co-financing	1999			Yes	Yes
Macedonia	Co-financing	1999			Yes	Yes
Moldova	Co-financing	2000		2005	No	Yes
Vietnam	Co-financing	2001		2002	Yes	No
Burundi	Co-financing	2006	2005	2007	Yes	Yes
Mozambique	Direct	1999	2000	2001	Yes	Yes
Mali	Direct	1999	2000	2002	Yes	Yes
Cape Verde	Direct	1999		2005	Yes	Yes
Tanzania	Direct	2000	2000	2000	Yes	No
Uganda	Direct	2000	2000	2000	Yes	No
Burkina Faso	Direct	2001	2000	2000	Yes	Yes
Ghana	Direct	2001	2001	2003	Yes	Yes
Benin	Direct	2003	2000	2003	Yes	Yes
Nicaragua	Direct	2005	2000	2001	No	Yes
Zambia	Direct	2006	2000	2002	Yes	Yes
Bhutan	Direct	2008		2004	No	No
Senegal	Direct	2008	2000	2005	Yes	No
Yemen	Incidental	1999		2003	No	No
Palestinian Territories	Incidental	2005			No	No

In line with the memorandum on macro-oriented programme aid, the track record contained an assessment of four clusters and eight aspects:

a *The assessment by multilateral organisations and policy dialogue*:
   1 assessment by IMF and World Bank of macro-economic policy
   2 space for policy dialogue
b *Macro-economic policy*:
   1 economic stabilisation policy
   2 structural reform policy
c *Good governance/institutional capacity*:
   1 transparency and effectiveness
   2 participation and legitimacy
d *Social development and policy*:
   1 poverty reduction
   2 gender.

The scores in the track record are based on a four-point scale, the argument being that this type of scale forces a choice to be made between satisfactory (B) and unsatisfactory (C).

Starting in 2004, the track record became a mandatory part of the assessment when embassies wanted a country to become eligible for budget support. Many other embassies also prepared track records for the 2004 annual plan. An adjustment was made in the course of the year, in which PFM and business climate were further integrated into the framework. The framework now consisted of the following clusters:

a Poverty reduction (A1 policy and A2 political commitment);
b Economic organisation (B1 macro-economic policy and B2 business climate/reform policy);
c Good governance (C1 PFM and C2 basic conditions for good governance);
d Dialogue (D1 quality of the policy dialogue and D2 harmonisation and alignment).

Budget support was possible as long as countries did not score a poor in a single cluster, and scored at least satisfactory in A, B1, C1 and D1.

The following figures compare the results of the track records for the years 2003 and 2007.[32] Because the track record was not mandatory for all embassies in late 2003, the total number for 2003 is less than for 2007.

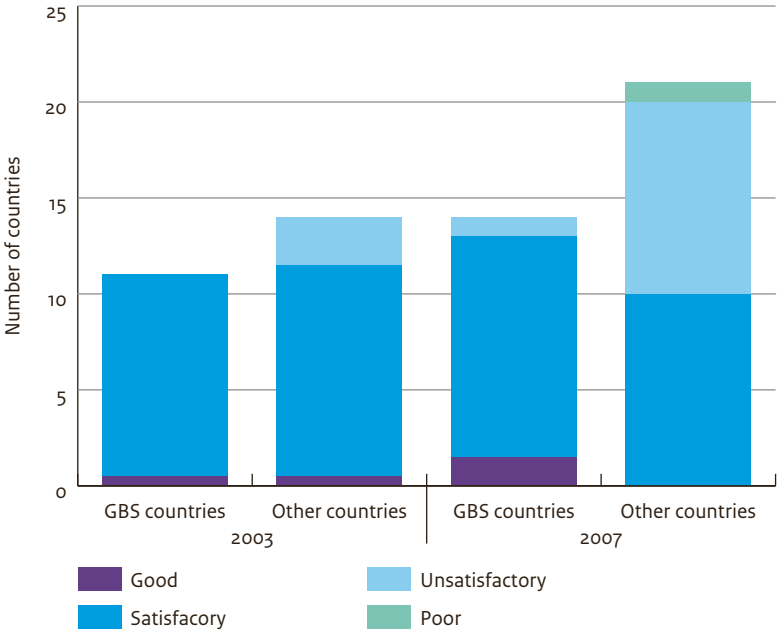
3.5.2 Poverty reduction policy and income

In 2003, all countries that received budget support from the Netherlands got at least a 'satisfactory' (B) for their poverty reduction policy (see figure 3.6). That year, mainly the poorer of the partner countries received budget support, including Burkina Faso, Ghana,

[32] 2003 is actually the first year in which development cooperation embassies systematically put together track records. These track records were mostly prepared in late 2003 and largely contain information about 2003. For 2007, IOB used the track records for the 2007 annual plan, because these played a part in the decision making for that year. Therefore, the 2004 track record contains information about 2003, and the 2007 track record has information about that year.

Mali, Mozambique and Uganda. Among the higher middle-income countries, only war-stricken Macedonia was given budget support (via the World Bank).

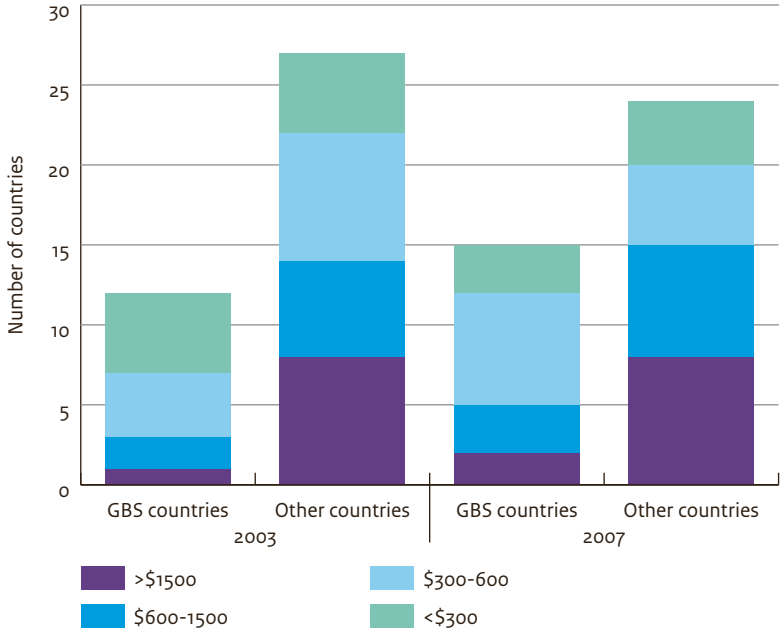
Figure 3.6: *Track record: Poverty reduction policy (2003 and 2007)*



Source: Track Records, Ministry of Foreign Affairs; adapted by IOB

In 2007, only the embassies in Georgia and Uganda concluded that the commitment of these countries to poverty reduction was unsatisfactory. The comparison for that year does confirm that countries receiving budget support had better assessments of their poverty reduction policies than other partner countries. Burkina Faso and Cape Verde received the best assessments that year. Budget support was also geared more to the poorer countries that year. Cape Verde and Armenia belonged to the most prosperous countries, relatively speaking, getting budget support from the Netherlands that year.

Figure 3.7: *Average income (2003 and 2007)*

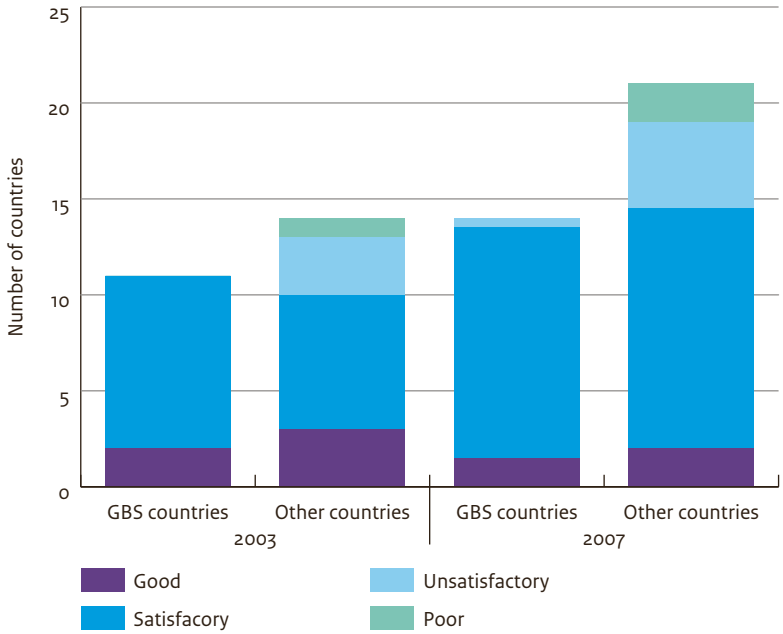


Source: World Bank (WDI); adapted by IOB

3.5.3 Economic policy and economic growth

Countries with general budget support received higher scores on average in both 2003 and 2007 for their economic policy, though some countries with good economic policies were not eligible for budget support (for other reasons). The reform policy of the government of Mali was the only one to be given an unsatisfactory mark in 2007, by the embassy in Bamako.

Figure 3.8: *Track record: economic policy (2003 and 2007)*



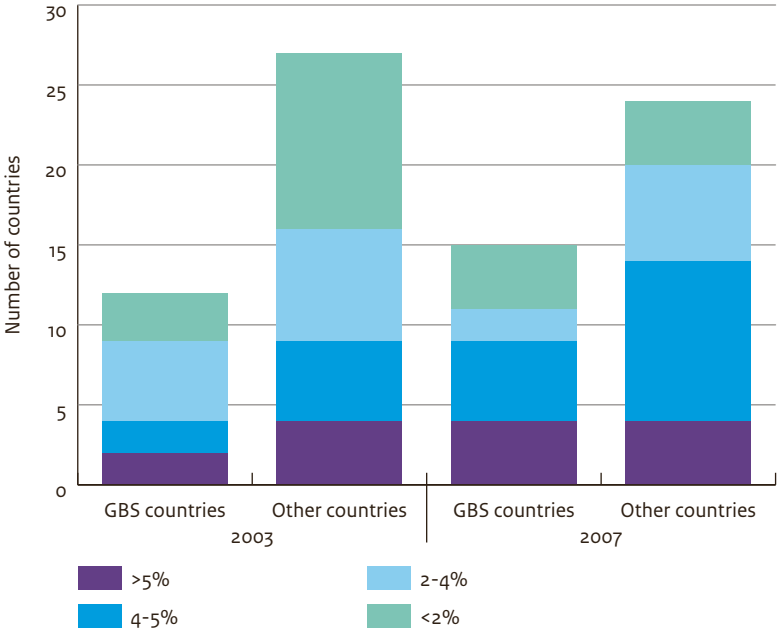
Source: Track Records, Ministry of Foreign Affairs; adapted by IOB

In 2003, countries with budget support had relatively large budget deficits, but the situation reversed itself in 2007. Various countries with budget support had reduced their deficits (such as Vietnam and Uganda). Bolivia had turned a substantial deficit into a budget surplus. The Netherlands suspended budget support to that country, partly for that reason, in 2006. The same was true for Kyrgyzstan in 2004.

For these two years, several countries whose economic policies were evaluated as satisfactory or good had relatively low growth figures (see figure 3.9). But the situation has improved. In 2003, most partner countries had per capita growth figures of less than 4% a year; in a significant number of cases this was less than 2% a year. Among recipients of general budget support, this included Bolivia and Mali. Armenia and Vietnam had the highest growth figures, closely followed by Tanzania and Mozambique.

Three years later, the average growth figures (over three years) were higher. This conclusion holds true especially for the partner countries that did receive general budget support. Incidentally, this partly concerns countries that no longer received budget support in 2007, such as Kyrgyzstan and Macedonia. Four countries with budget support had relatively low growth figures in 2007 (per capita of the population): Burundi, Benin, Burkina Faso and Mali. The assumption that countries with general budget support perform less well than countries without it did not hold for the Dutch partner countries during this period. Chapter 6 discusses this in more detail.

Figure 3.9: *Economic growth (2003 and 2007)**



* *Average growth figures over a period of three years (i.e. 2002–2004 and 2006–2008).*

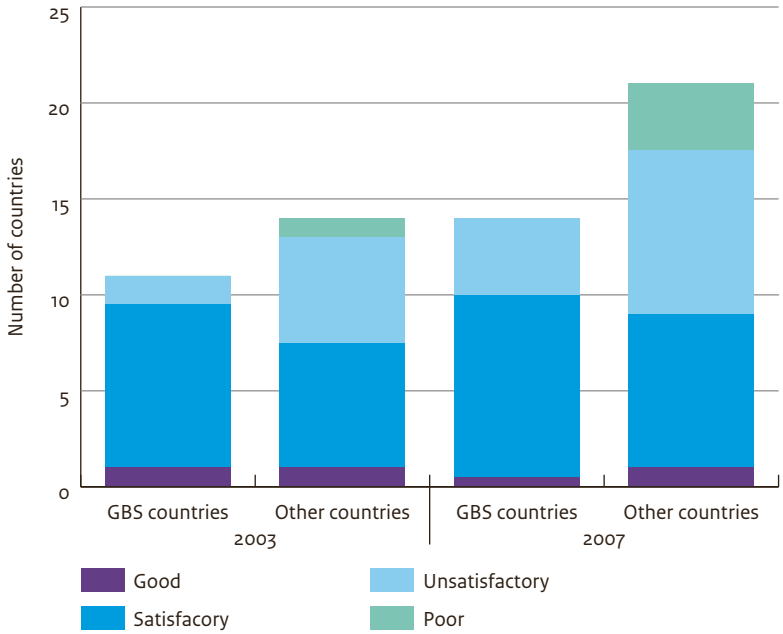
Source: World Bank (WDI); adapted by IOB

3.5.4 Good governance

The track record has two indicators for good governance: 1) transparency and effectiveness, and 2) participation and legitimacy. The first indicator refers especially to the institutional capacity and the quality of financial management; the second indicator focuses on civil liberties and respect for the rule of law.

In 2003, Armenia had an unsatisfactory score for good governance. In this case, it did concern direct general budget support, but co-financing through the World Bank. In 2007, Mali, Moldova, Uganda, Vietnam and Zambia also had lower scores for quality of governance. In all cases, it concerned a C (unsatisfactory) for participation. Effectiveness of governance was satisfactory in all cases.

Figure 3.10: *Track record: Good governance (2003 and 2007)*



Source: Track Records, Ministry of Foreign Affairs; adapted by IOB

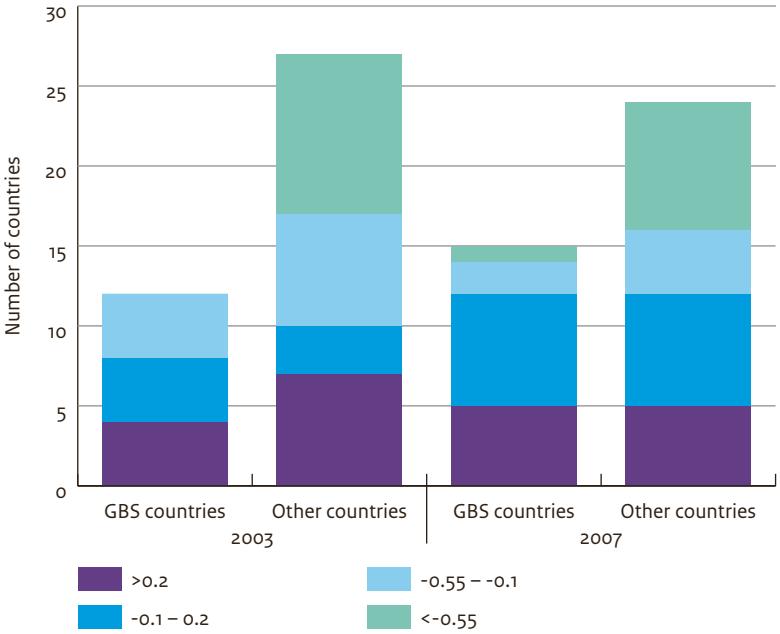
We also examined the quality of governance based on the six Kaufmann indicators (freedom of expression and democratic accountability, political stability, government effectiveness, regulatory quality, rule of law and control of corruption, see also chapter 5). These indicators can be seen as an expression of a latent (not immediately measurable) and variable good governance. We combined them with principle component analyses to create one indicator for good governance.[33] Figure 3.11 displays the results for 2003 and 2007. Annex IV presents results for the individual indicators.

Indeed, it turns out that for 2003 none of the countries with budget support belong to the lowest category (<-0.55). However, several countries with low scores did receive budget support: Kyrgyzstan, Tanzania, Uganda and Vietnam. Of these four countries, Kyrgyzstan no longer got budget support in 2007, and Tanzania, Vietnam and Uganda had improved their scores in 2007. Uganda was one of the countries with the lowest scores that year, with Burundi and Nicaragua. Nicaragua's scores had worsened following a change of power early that year.
On the whole, countries with budget support seem to have had higher scores on the Kaufmann indicators in 2007. This is partly connected to new countries receiving budget

[33] The calculation is based on all countries that received ODA between 2000 and 2010. For all these countries and years, the mean is therefore 0, with a standard deviation of 1.

support (such as Cape Verde, Georgia and, to a lesser degree, Zambia and Moldova). In addition, various countries that already received budget support had higher scores in 2007.

Figure 3.11: *Good governance (2003 and 2007)**



* *Based on the six Kaufmann indicators.*

Source: World Bank (Worldwide Governance Indicators); adapted by IOB

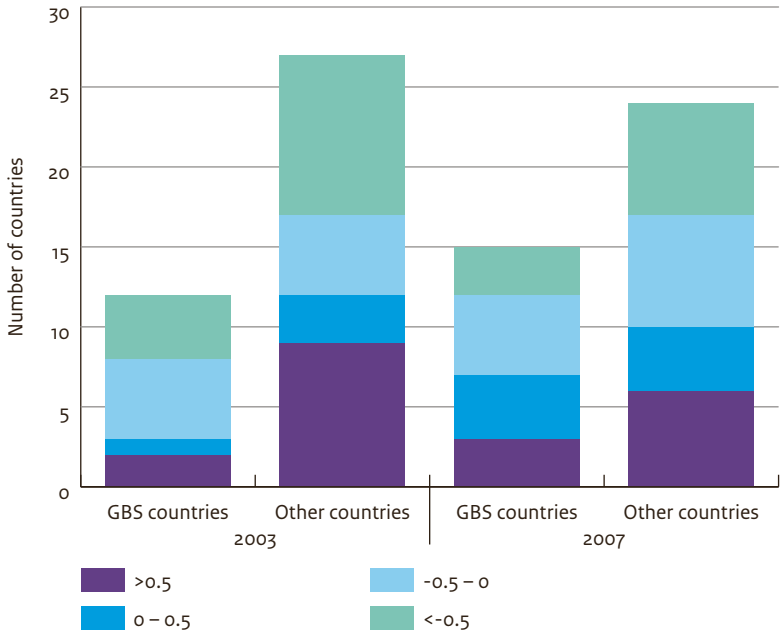
An element that has received greater attention in recent years is the fight against corruption as a condition for budget support. An official *Anti-Corruption Task Force* concluded in 2007 that seven countries were no longer eligible for budget support: Armenia, Georgia, Moldova, Mozambique, Tanzania, Uganda and Vietnam.[34]

We used two indices for the analysis here: both the Kaufmann index (for the 'control of corruption' dimension) and the Transparency International index. Neither of the indicators shows a clear relationship between corruption and budget support: partner countries with less corruption did not stand a better chance of receiving budget support. Figure 3.12 shows the results of an amalgamation of scores from the Transparency International index and the Kaufmann indicators.[35] Both scores, incidentally, are based on perceptions.

[34] The Task Force also examined the scores for other dimensions, namely voice and accountability, and rule of law.

[35] This amalgamation was also done with principal component analysis in order to guarantee that both indicators carried the same weight. For both these years and for the partner countries the mean is 0, with a standard deviation of 1. The units also give the halves of a standard deviation of the mean.

Figure 3.12: *Budget support and corruption (2003 and 2007)*



Source: World Bank (Worldwide Governance Indicators) and Transparency International; adapted by IOB

Table 3.8 is based on the scores from both indicators and displays the levels of corruption in countries that received budget support.

Table 3.8: Budget support and the perception of corruption (2003 and 2007)

	2003	2007
High level of corruption	Kyrgyzstan, Uganda Bolivia, Tanzania	Burundi, Nicaragua, Uganda
Fairly high levels of corruption	Armenia, Vietnam, Mozambique, Benin, Macedonia	Moldova, Zambia, Armenia, Vietnam, Mozambique
Relatively moderate levels of corruption	Mali	Tanzania, Benin, Mali, Burkina Faso
Relatively low levels of corruption	Burkina Faso, Ghana	Georgia, Cape Verde, Ghana

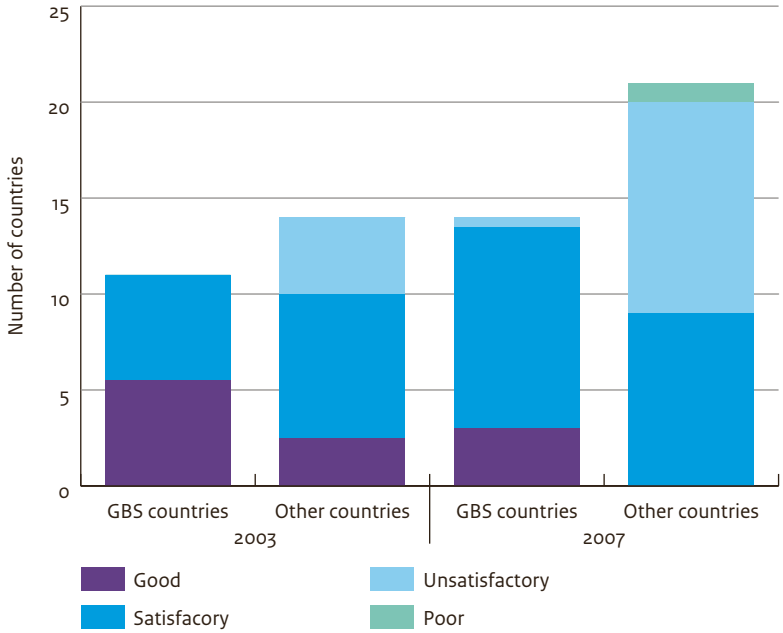
Source: World Bank (Worldwide Governance Indicators) and Transparency International; adapted by IOB

The table shows improvement in a few countries, while it was the 'newcomers' in particular (Burundi, Nicaragua and Zambia) that had low scores in 2007. The official *Anti-Corruption Task Force* did not give these countries a negative assessment, while the negative rating of Georgia is not backed up by either of the indices.

3.5.5 Dialogue

The fourth cluster evaluates the dialogue, including a) the quality of the policy dialogue and b) harmonisation and alignment. To be eligible for budget support, countries had to score satisfactory on the first indicator.

Figure 3.13: *Track record: Dialogue (2003 and 2007)*



Source: Track Records, Ministry of Foreign Affairs; adapted by IOB

The results show that countries with budget support scored better on this point in both years than other partner countries. A comparison across time, however, also reveals that the dialogue ratings simultaneously worsened, even in countries with budget support. Armenia had the lowest rating of this group in 2007 (for harmonisation and alignment). Burkina Faso was the only country with good ratings on both indicators.

3.5.6 Conclusions

Partly because of pressure from the Court of Audit, the ministry attempted to develop more objective criteria for providing budget support. This is difficult in practice, however, if not an illusion, because political considerations can rarely be based on this. Indeed, figures show that the scores, certainly when they involve perceptions, can change quickly.

We have tried to find out whether countries with budget support do in fact score better on average on the track record. That is indeed the case:

- Countries with budget support had better scores on average in both years for poverty reduction policy than other countries. In addition, on average they were also poorer countries;
- When it comes to economic policy, the difference is less clear, keeping in mind that countries with budget support were not evaluated as unsatisfactory on this point for either year. On the other hand, the relationship between the assessment of economic policy and economic growth (per capita of the population) is not equally clear in all cases;
- One of the biggest differences between both groups is in the good governance cluster, where countries with budget support had clearly higher scores. It is striking, however, that the assessments by the embassies have become more critical, while the Kaufmann scores generally show improvement, though Burundi, Uganda and Nicaragua are negative highlights in that respect;
- There seems to be no pattern whatsoever when it comes to corruption, albeit that in 2003 countries with budget support had relatively high levels of corruption. This improved in 2007, the exceptions again being Burundi, Nicaragua and Uganda;
- There were also big differences in quality of dialogue, with good assessments going to countries that would lose their budget support shortly thereafter (Uganda and Vietnam).

The classic argument of 'buying your way in' appeared to play a part in the decision to provide budget support. When budget support was finally granted, then its continuation essentially depended on completely different factors than those in the manuals. Political or other incidents (such as in Nicaragua, Rwanda and Tanzania) often determined whether the support would be terminated, suspended or not granted. Uganda was a clear exception. The ministry first attempted to improve governance there through dialogue. Since the ministry made no progress in its attempts, it terminated the general budget support. Vietnam scored low on most (western) indicators for good governance, but it was more successful in fighting poverty than other countries that received budget support (see also chapter 7).

3.6 Summary and conclusions

Budget support emerged, on the one hand, from other forms of macro-oriented programme aid, such as balance of payments support and import support. The instrument entered the picture after these forms of aid lost their practical meaning. There are also important differences. Other forms of macro-oriented programme aid were primarily incidental, while the ministry wanted to use budget support to be structurally linked to

partner countries' policies and exert influence there on the policy dialogue. A second difference is that the objective of earlier forms of macro-support mainly was mainly macro-economic stability, whereas budget support made a far greater attempt to dovetail with national strategies to reduce poverty. Budget support also emerged from uncertainties about the effectiveness, efficiency and especially the sustainability of project aid. These uncertainties were also infused with pragmatic considerations, because the Netherlands did not have the personal capacity to expand bilateral aid using familiar project paths.

The use of general budget support slowly took shape from 2000 onwards. Initially it concerned mainly incidental support, and the difference between it and other forms of macro-support were not always equally evident. General budget support was not the core policy instrument for the ministers in question either. They pushed primarily for the sector-wide approach, and in a number of cases did grant sector budget support. The structural use of the instrument started in 2002, in line with international developments. Indeed, the emphasis shifted from incidental support and the co-financing of World Bank programmes to direct general budget support. Another shift also occurred, one in which good governance went from being a condition to an objective.

The turnaround came in 2008. While the High Level Forum in Accra that year confirmed the agreements on harmonisation, alignment and ownership made in 2005, the climate regarding this modality started to deteriorate in the Netherlands. This was partly the consequence of problems in several countries that received budget support. These were both political problems and cases of corruption. The minister at the time seemed to become more critical of this instrument as well, but, what is more, he had harsh confrontations with an increasingly critical House of Representatives. In 2010, the new coalition partners decided to drastically reduce the use of the instrument.

The Netherlands spent approximately €1.75 billion on general budget support between 2000 and 2011. This is about 3.4% of the total ODA during this period. The expenditures on sector budget support – which are not examined any further in this review – amounted to about €925 million.

Dutch policy and its implementation developed incrementally. The ministry worked continuously on new criteria and manuals for budget support, but the reality was that other, among them political, considerations dominated decision making. Partner countries that received debt relief in the context of the HIPC initiative and produced a PRSP would be the main ones receiving budget support, which points to the importance of international considerations. Criteria in the area of good governance seemed *in practice* to play much less of a role, even though countries that received budget support had scored relatively high in assessments of the quality of their governance compared to other partner countries. Often, the termination of budget support was also based on international political developments and incidents and much less on the testing of criteria for general budget support.

Further elaboration of the intervention logic would have been much more important than the development of manuals and criteria. That never happened. Budget support had to

contribute to more efficient, more effective and more sustainable poverty reduction, but what exactly it should accomplish and how was never explicitly explained. The literature on budget support highlights two conditions:

1 the socio-economic policy in the recipient country had to correspond to Dutch starting points, and
2 the country in question had to possess institutional capacity.

The second condition was never really tested. So it was not a question of whether the recipient country had their financial management in order; instead, improvement of financial management became one of budget support's main objectives.

The first condition was expanded to include good governance, in order to subsequently arrive at a complex synthesis of starting point and objective. Good governance formally belonged to the most important criteria for the provision of budget support, even though countries that qualified for budget support did not have (much) higher ratings on the various indicators than other countries. Indeed, good governance was not a cast-iron condition, but countries had to have the *intention* of improving their policies. Countries had to meet good governance demands, even though budget support was primarily viewed as an instrument to improve good governance. Moreover, 'policy dialogue' and not financing was the main tool. More than anything, budget support was the carrot.

The instrument slowly drifted away from the original objectives and conditions, and poverty reduction was increasingly pushed to the background, while promoting good governance and political dialogue were increasingly in the foreground. While internal memorandums and letters to the House emphasised on several occasions that budget support could not buy reform, policy was certainly aimed at just this, even though the minister formally claimed otherwise several times. It is also telling that the minister never terminated budget support because of uncertainty about the commitment to the main objective of aid, a government's poverty reduction policy, but he did terminate it if a country achieved poor results in the area of good governance.

The conclusion is that the Netherlands transformed the conditions for budget support into objectives. This created an ambiguous hierarchy of objectives. Because the policy theory had not been developed into a clear intervention logic, high expectations were created that had not been tested in real circumstances. The Netherlands, by the way, was not alone in this.

4

Direct impact of budget support funds

4.1 Introduction

This chapter addresses the direct impact of budget support *funds*. According to policy theory (chapter 2), these unearmarked funds create more government spending on poverty reduction and in the social sectors. Budget support's impact on the *composition* of government spending and its results will be discussed in chapter 7. This chapter focuses on the impact on total government expenditure. Theoretically, the impact of unearmarked funds through the budget support channel is no different from other, earlier forms of programme aid, such as balance of payments support. That is why this chapter starts by explaining the potential macro-economic impact of these funds on the balance of payments, on the government budget (expenditures, tax revenue and deficit) and on macro-economic stability. Of course, the different kinds of impact depend on the actual size of programme aid (in the 2000s: budget support), and also on the degree of predictability. Finally, this chapter devotes attention to budget support's transaction costs. When these costs go down, the same effort as before will free more funds for the government.

4.2 Theory

The impact of budget support *funds* is equal for all forms of programme aid (macro-support), and also for other aid modalities – to the extent they are fungible.[36] A given amount of aid is an inflow of currency that affects a country's external balance, its internal balance and, as part of the latter, the government budget. The impact of aid can be analysed with the help of a marginal analysis based on identities for the external and internal balance (White and Dijkstra 2003).

[36] Aid is fungible if it is can be used for another purpose than originally intended (see also section 2.3).

Table 4.1: Identities for measuring the impact of aid

External balance	Internal balance	Internal balance with government
+ Exports (EXP)	+ Savings	+ Government revenue
+ Official transfers (OT)		+ Private savings
+ Private transfers (PT)		
- Imports (IMP)	- Investment	- Government expenditure
- Interest payments		- Private investment
Equals:	**Equals:**	**Equals:**
- Aid loans	*- Aid loans*	*- Aid loans*
- Other net capital inflows (OCI)	- Other net capital inflows	- Other net capital inflows
- Change in reserves (ΔR)	- Changes in reserves	- Changes in reserves
- Errors and omissions (capital flight) (EO)	- Errors and omissions (capital flight)	- Errors and omissions (capital flight)
	- Private transfers	- Private transfers
	- Official transfers	- Official transfers

Source: White and Dijkstra 2003.

The current account of the balance of payments is at the top of the first column, and the capital account is at the bottom. For the internal balance, the lower part reflects foreign contributions to savings. This contribution includes the same elements as the capital account, plus transfers. Development aid consists of grants (official transfers), which are registered in the current account, and long-term loans, which are in the capital account. Table 4.1 depicts net flows, but it is easier in the analysis to focus on gross flows and to take the repayment of loans and the interest payments together as debt payments (DP). The 1st column in table 4.1 can then be written out as:

$$AID - IMP - PT + DP - EXP - OCI - \Delta R - EO$$

This is an identity: if the aid changes, at least one of the other variables has to change as well. Aid can therefore lead to more imports, increased reserves (represented by a negative ΔR) or more debt payments, but it can also decrease exports or other capital inflows or lead to capital flight (represented by –EO). When aid is used to pay debts (which would not have otherwise been paid) or to increase reserves, or when the aid results in capital flight, less net inflows of other capital (direct foreign investment, trade credit or commercial loans) or private transfers, then the impact on the internal balance will be less as well. These financial posts from the external balance are carried over to the internal balance.

4.2.1 Internal balance

After deducting any potential increases of foreign reserves, capital flight, or less inflow of other capital and additional debt payments, aid to governments can be used to increase expenditures or decrease the financing of deficits, but it can also result in less tax revenue. The latter has been extensively studied in the 'fiscal response' literature, which is briefly summarised in section 4.5. When government revenue remains equal and aid is fully spent, the deficit automatically increases with the amount of aid. To the extent that the deficit does not increase in proportion with the aid flow, aid will reduce the government's demand for domestic capital or decrease monetary financing of the deficit.[37] If the government borrows less from the domestic capital market, private investment can increase or private savings decrease. If there is less monetary financing of the deficit, then aid will contribute to macro-economic stability.

Penrose (2008) argued that most governments apply the budget rule that current expenditures are financed by tax revenue. Loans, as well as aid, can then only be used for investment. This proved usually the case in Africa, though there are some exceptions, especially in post-conflict countries such as Burundi, but also in other countries with extensive foreign aid, such as Malawi and Tanzania. According to the author, this means that budget support, to the degree that it is used, will often finance investment. Because investment implies higher current expenditures in the future, it is important that tax revenues increase.

4.2.2 Macro-economic stability

Macro-economic stability is important both externally and internally. External instability points to a crisis of balance of payments. Debts or imports can no longer be paid, and foreign countries are no longer willing to lend. Internal stability is about the stability of domestic prices. We speak of instability when there is very high inflation. Both external and internal stability are a necessary condition for economic growth and therefore also for poverty reduction. Moreover, inflation (lack of internal stability) affects the incomes of the poorest, in particular.

Development aid can contribute to macro-economic stability in several ways. In countries threatened by of a balance of payments crisis, debt payments are usually high, reserves low and there is capital flight. In all these cases, aid will contribute to stability. In countries with high inflation, aid can contribute to stability in at least five ways:

1. by financing a government deficit in a non-monetary way, which will decrease the domestic supply of money;
2. by settling domestic debts previously incurred by the government;
3. by influencing economic expectations in a positive way and consequently increasing demand for the domestic currency (vis-à-vis the foreign currency);

[37] Most recipient countries nowadays no longer finance their deficits monetarily (by borrowing from the Central Bank, i.e. printing more money), but on the domestic capital market. Some countries succeed in attracting foreign capital.

4 by making it possible to import more – if a fixed exchange rate applies – so that domestic prices will fall; and
5 by financing additional government expenditures in a non-monetary way that are necessary to increase production (in increase in the supply of goods).

All the mentioned effects are 'first round' effects. In practice, there will always be second and subsequent rounds. Aid will promote economic growth, for example, which will increase tax revenue or exports, which in turn will affect other variables.

4.2.3 Predictability

A lack of predictability harms aid effectiveness (Lensink and Morrissey 2000). Unpredictability is about the difference between commitments and disbursements, and therefore about the degree of certainty of the aid flow. There are two aspects to unpredictability: transparency (the timely provision of information to the recipient about the size and kind of aid in question) and reliability (Lister 2011). Since no reliable figures are available about annual aid commitments, predictability is often measured as volatility (fluctuations in the size of aid), even though this is not exactly the same thing. But volatility in itself can also create problems for the management of government finances.[38] One of the expectations about budget support was that this aid modality would be more predictable than others. This is a questionable expectation. For one thing, it is easier for donors to terminate programme aid, including budget support, than project aid, because the cost of terminating this kind of aid is not visible in the projects financed by donors. Second, budget support is accompanied by more extensive entry conditions, including the underlying principles, than project aid or previous forms of programme aid. Before 2000, the size of programme aid was mainly connected to the presence or absence of an IMF agreement. In the context of budget support after 2000, assessments of recipient countries focus on many more 'underlying principles', in addition to macro-economic stability (which usually still means having an IMF programme) also on reliable public financial management and absence of corruption, respect for democratic principles and human rights. It is difficult to determine clear criteria and threshold values for these principles, so that potential aid cuts are difficult to predict for the recipient. Third, budget support is often linked to a performance framework that also contains results-based indicators. Some donors, especially (though not exclusively) the European Commission, base part of their disbursements on the degree to which results are achieved. Theoretically, this causes predictability to decline (Eifert and Gelb 2006).[39] The Commission has tried to obviate this problem by disbursing the performance tranche in the following fiscal year. The discussion about to what degree objectives are achieved often leads to delays, however. Fourth, the unpredictability and volatility of budget support can exceed that of project aid or earlier modalities of programme aid, because donors are supposed to coordinate their

38 The loss caused by volatility can be as much as 15% to 20% of the aid; see Kharas (2008) and Bigsten et al. (2011).

39 Eifert and Gelb (2006) argue that selectivity based on performance indicators creates a balance at a low level. Recipients do not withdraw all committed budget support, and donors, in turn, commit less budget support because not all of it is being used.

responses (Nilsson 2004). If they indeed do so, we speak of a 'nuclear threat' as opposed to a gradual response.

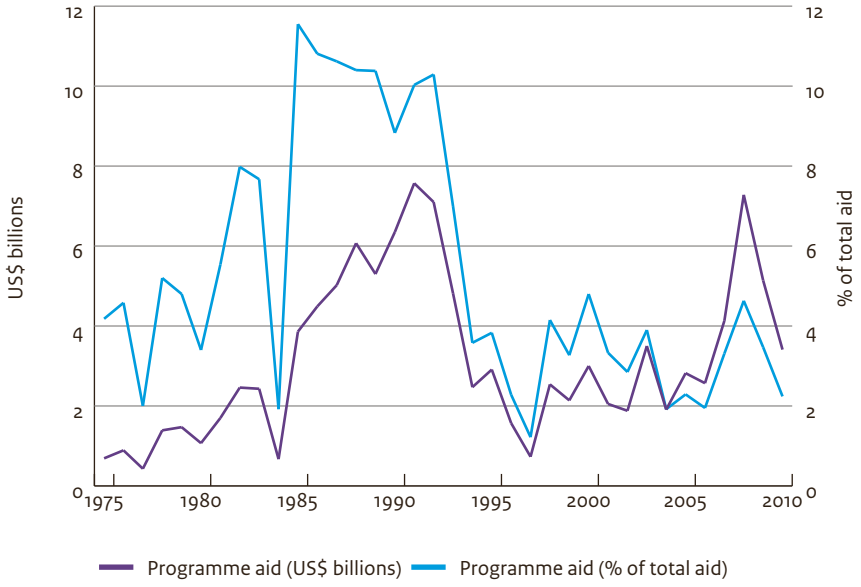
The degree of volatility and predictability affect how budget support is used. If budget support fluctuates strongly from year to year, and if there is a big difference between commitments and actual disbursements, then it is more difficult for recipient governments to use the funds for extra expenditures, but also to levy fewer taxes. In such situations it is likely that (additional) budget support will be used (partly) to finance the deficit or pay off previously incurred public debt. If donors do not honour their commitments, it can be expected that the deficit will increase and that governments have to borrow more because expenditures cannot be adjusted anymore. It is also important in which quarter budget support is disbursed. If a large portion of budget support is disbursed in the last quarter, then there is less chance that the whole amount will be spent, even if there was great certainty about receiving the funds.

4.3 Size of budget support

The first question is whether there actually was a shift from project aid to budget support in the 2000s. It is important to consider all non-earmarked support here, because budget support was rare in the 1990s, whereas other modalities of non-earmarked support such as balance of payments support and debt relief were more common. Debt relief, however, did not always free up funds for recipient countries, for example if the debt would not have been paid off. That is why we are presenting figures for programme aid both with and without debt relief.[40] Without debt relief, programme aid in absolute numbers appears to only have been substantially higher in the years 2007–2009 than in the years 1994–2000, but not or barely higher than between 1985 and 1993 (figure 4.1). And even during its peak in 2008, programme aid only constituted 4.2% of total aid. This level was also reached in 2000, and it was 3.7% in 1998. Viewed in the long term, programme aid as a share of total aid was much higher between 1985 and 1993. These were the glory days of structural adjustment programmes, though it should be noted that import support was a favourite modality during this time, and this was sometimes tied aid.

[40] In all cases, we deducted food aid.

Figure 4.1: *Long-term trend in programme aid, excluding debt relief (1975–2010)*



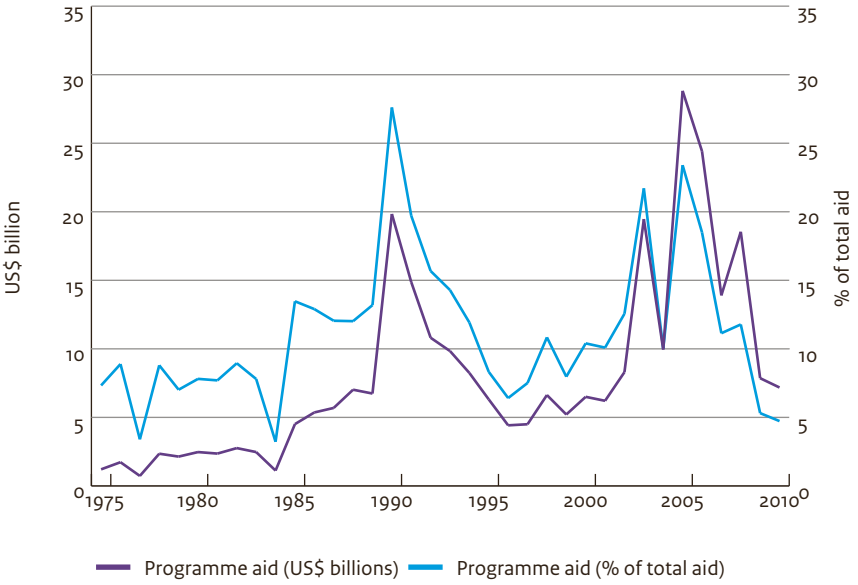
Source: OECD/DAC, Aggregate aid statistics. Figures are aid commitments per year for DAC donors plus the EU. Unfortunately there is no long-term data for aid disbursements.

If we factor in debt relief, the absolute and relative numbers are significantly higher, also for the period following 2000 (figure 4.2). Programme aid between 2002 and 2008 accounts for 10% to 20% of total aid, but this subsequently decreases again to about 5% in 2009 and 2010. But the high figures in 2005 and 2006 can be largely attributed to politically motivated debt relief for Iraq and Nigeria. The same is also true, incidentally, for the peak in 1990, which can be explained by debt relief to Egypt and Poland.

The disbursement figures for budget support from 2002 onwards show that the average share of general budget support to all recipient countries in the period 2002–2009 was 3.6% of total aid.[41] So this pretty much tallies with the long-term data presented above about commitments. For individual countries, the share of programme aid is often higher than the approximately 4% of total aid. But here too, sometimes the share of programme aid in the new millennium did not increase compared to the 1990s. Dijkstra and Komives (2011) demonstrate this for Bolivia, Honduras and Nicaragua, for example, where the share of programme aid was approximately 22% in the 1990s and decreased to 19% (Bolivia) and 13% (Honduras and Nicaragua) respectively after 2000.

[41] Source: OECD/DAC CRS database.

Figure 4.2: *Long-term trend in programme aid, including debt relief (1975–2010)*



Source: See figure 4.1

The figures on disbursements from the DAC CRS database include budget support from bilateral donors, from the EU and from regional banks. The World Bank reports its Poverty Reduction Support Credits (PRSCs) as sector support. We have therefore added the volumes under PRSCs separately to the DAC CRS data on budget support.

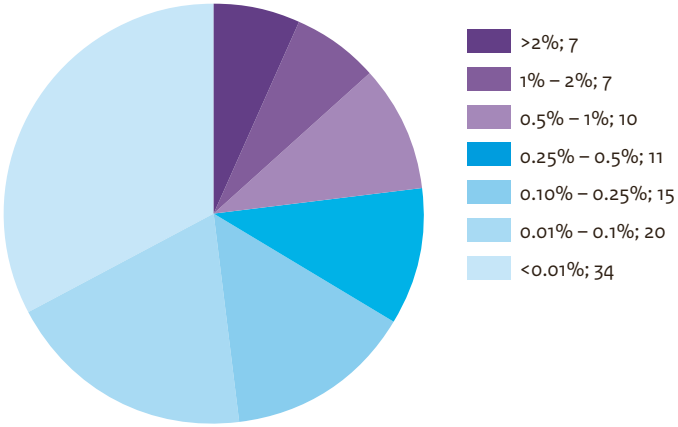
Table 4.2 shows figures about budget support as a percentage of gross domestic product (GDP).[42] Figure 4.3, in addition, shows the distribution of average budget support as a percentage of GDP for these countries during the period 2002–2010. Both make clear that budget support had relatively little significance in many countries during this period. Budget support was not higher on average than half a per cent of the GDP. It was only higher than 0.5% of the GDP in less than 24 countries during this entire period (see figure 4.3).

[42] Data from the DAC CRS database plus data from IEG 2010 for PRSC disbursements. The selection was as follows: all low- and middle-income countries (WDI classification by the World Bank in 2010) that received positive ODA in 2006, with the exception of countries with less than 500,000 inhabitants. In addition, countries with an income of more than US$5,000 per capita in 2002 were left out of the analysis. These countries barely received any budget support either. We have made exceptions with Afghanistan and Iraq because of their special conflict situations. China has also been *a priori* left out of the analyses because this country could have too great of an impact on the calculations in a number of cases.

Table 4.2: Budget support as % of the GDP in 104 countries										
	2002	2003	2004	2005	2006	2007	2008	2009	2010	Average
Average	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Maximum	3.9	8.6	6.8	6.0	3.7	7.9	6.0	5.3	5.4	6.0

Source: OECD/DAC and IEG (2010); adapted by IOB.

Figure 4.3: *Budget support in relation to GDP (averages 2002–2010; number of countries)*



OECD/DAC database and IEG 2010; adapted by IOB.

Assuming a minimum of 0.25% of GDP, 35 countries with at least half a million inhabitants received substantial budget support between 2002 and 2010. Of these 35, for 31 countries this was also at least 2.5% of total ODA. On average, it concerned an amount of US$86 million a year with a maximum of US$127 million in 2009 (see table 4.3). The median (the middle value) was significantly lower, which indicates that most countries received less than the mean. A number of extensive incidental payments had a major impact on the average figures. Examples include a payment of more than US$880 million from the United States to Jordan, and an amount of US$ 590 million from Japan to Vietnam. On average, budget support in these 31 countries constituted 1.4% of GDP and 7.6% of total aid.

Table 4.3: Index numbers for budget support in 31 countries that received substantial support (2002–2010, in US$ millions)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	Average
Mean	31	78	61	71	88	87	124	127	103	86
Median	15	24	42	48	54	46	70	59	63	47
Maximum	139	882	309	377	426	589	502	711	464	489
Average in % of GDP	1.0	1.5	1.6	1.4	1.4	1.5	1.5	1.5	1.3	1.4
Average in % of total ODA	5.0	8.1	6.5	6.6	4.1	7.4	10.3	9.5	7.6	7.2

Source: OECD/DAC database; adapted by IOB

In 17 sub-Saharan countries, programme aid constituted 30% of total aid, and this remained just about constant between 2002 and 2005 (Knoll 2008). This figure corresponds neatly with the averages for the four African country case studies in this policy review (table 4.4). Tanzania stands out with 42%. Budget support's share of total aid was significantly lower in Nicaragua and Vietnam than in Africa, but still higher than the worldwide average of 4%. Budget support's share of total aid remained fairly constant in all countries, but that was attributable in all cases (except Nicaragua) to a growing aid package. On average, budget support was good for 19% of government expenditure in Tanzania, but in other countries this was between 2% and 9%. Table 4.4 also presents averages: in most countries, GBS decreased over the years as a share of government expenditure, especially as a consequence of higher own revenues.

Table 4.4: Share of GBS of total aid and in government expenditure (annual averages as a per cent)

	Ghana ('04-'10)	Mali ('03-'09)	Tanzania ('05-'10)	Zambia ('06-'10)	Nicaragua ('05-'08)	Vietnam ('01-' 06)
As % of total aid	29	25	42	30	13	10
As % of government expenditure	9	9	19	6	6	2
As % of GDP	2.1	2.1	4.0	1.4	1.4	0.2

Source: Country case studies

4.4 Predictability

4.4.1 Literature review

Fielding and Mavrotas (2005) confirmed the expectation expressed above that programme aid would fluctuate more than project aid. Indeed, they found that this was the case for the period 1973–2002. But programme aid during this period was primarily import support, balance of payments support and some debt relief, not (or barely) budget support. Bulir and Hamann (2003) asked IMF representatives in 37 countries about the difference between commitments and disbursements for programme aid and project aid for 1998.[43] Commitments appeared to be about 25% higher than disbursements. Project aid predictions appeared to be sounder than the ones for programme aid.

A survey organised by the SPA's budget support working group, as reported in Celasun and Walliser (2006), shows that 81% of commitments for budget support in 2003 were actually disbursed, and another 10% a year later. The reasons for not disbursing committed support were, in 40% of the cases, that certain policy conditions were not met, and in 25% of the cases, that the donor was having administrative problems. There are other reasons for late disbursments, incidentally. When monitoring information is made available too late, for example, or when sector and general reviews are organised too late, or when items of evidence or payment requests are handed in late.

Celasun and Walliser studied the relationship between commitments and disbursements in eight African countries, also based on IMF projections and figures. They compared two time periods: 1993–1999 and 2000–2004. The average, absolute deviation during the first period was 1.13% of GDP, and slightly lower in the second period at 0.95% of GDP. During the first period, programme aid was an average of 34% lower than committed, and during the second period an average of 10% higher. This might suggest that predictability has increased. But given the method of measuring this, the improvement could also be the result of more stable exchange rates in recipient countries. Also in the second period, programme aid proved to fluctuate more than tax revenue.

The joint evaluation of budget support (IDD and Associates 2006) demonstrated that there was a problem, with disbursements late in fiscal years, especially in the beginning, which made expensive domestic loans a necessity. This happened in countries such as Rwanda, Burkina Faso and Mozambique. But in later years, timeliness of payments improved. Budget support to Nicaragua and Malawi was suspended because neither country met IMF requirements. Strictly speaking, this was predictable, and yet government officials in both countries were apparently taken by surprise. Donors do not have a strong track record when it comes to actually suspending payment. Budget support was anything but predictable in Tanzania from 2000–2001 and 2001–2002, but it did improve in the two subsequent years (Lawson et al. 2005). Later evaluations are more positive about predictability. The IEG evaluation of PRSCs concluded that budget support results in more predictable

[43] This concerns aid from other donors, and not loans from the IMF.

disbursements through harmonised systems. Recipients still complain that most disbursements take place late in the fiscal year (IEG 2010), but timeliness of disbursement of sector support to sector ministries is not worse than releases by their own ministries of finance (De Kemp, Faust and Leiderer 2011). A study for the British DFID shows that an average of 96% of committed budget support from 2000–2001 to 2007–2008 was actually disbursed as planned (National Audit Office 2008).

As far as the impact of unpredictability is concerned, Celasun and Walliser (2006: 225) concluded for eight African countries that when governments receive less budget support than expected, they respond by borrowing more domestically or by investing less. If money materialises unexpectedly, then it is used to reduce domestic debt, not to make more investments. In other words, the response is asymmetrical. Knoll (2008) examined the impact of the difference between commitments and disbursements of programme aid on government deficits in 18 African countries over a 10-year period, 1996–2005.[44] He found that this difference led to a significantly higher budget deficit; on average, one euro less budget support than expected led to a 70-cent increase in the deficit.

4.4.2 Case studies

Most of the studies mentioned above are somewhat outdated and focus mainly on early forms of programme aid or on the early days of general budget support. It is not possible to draw conclusions from these studies for the most recent years. The six case studies for this evaluation, however, show that the predictability of aid has improved in recent years.

This was clearly the case in Ghana and Mali. In recent years, donors actually disbursed 90% and 94%, respectively, of the committed funds in a given fiscal year (see table 4.5). Predictability was good in Nicaragua in 2006 and 2007, but less so in 2005 and 2008. The reason for this was that donors did not believe that Nicaragua was abiding by the underlying principles. All budget support in Vietnam occurred through co-financing through the World Bank's PRSC. The predictability of the World Bank's funds was good, but the co-financers were sometimes late in declaring their commitments or paid later than agreed. The opposite was true in Zambia, where the World Bank's budget support was less 'predictable'. In this country, donors disbursed more from 2008 onwards than they had committed.

The timing of disbursements within a given fiscal year was not entirely positive in the six countries. The government was not satisfied with the predictability within a fiscal year in Ghana and Vietnam, and the majority of disbursements to Nicaragua were made at the end of the year, which essentially meant that budget support could not be used. Delays, especially with variable tranches, led the Malian government to take out expensive domestic loans. Delays can also be the result of developments in the partner country, incidentally. Sweden, for example, suspended budget support to Zambia in 2009 after a corruption scandal came to light in the Ministry of Health.

44 The source is the CRS database, with the aforementioned problem of overestimating the differences between commitments and actual disbursements, since commitments are often for multiple years.

Table 4.5: Predictability of budget support in six countries

	Ghana	Mali	Tanzania	Zambia	Nicaragua	Vietnam
Predictability for coming year	Not good for 2006, after that 90%	Good, especially from 2007 onwards: 94%	Has improved	Good, especially from 2008 onwards	2006 and 2007 good, less so in '05 and '08	World Bank good, others less so
Timing within year	Often other than agreed	Delays, especially of variable tranches. Has improved	Most in 1st and 2nd quarters	Average delay 3-4 months	Most in 4th quarter	Not coordinated between donors

Source: Country case studies

4.5 Macro-economic impact of budget support

4.5.1 External balance

Evaluations of budget support usually only focus on analysing the effects on government budgets and sometimes also on macro-economic stability. The above analysis, however, shows that the impact on the external balance also has consequences on the internal balance. It is especially important to examine what aid's impact is on debt payments, other capital inflows, other private transfers, capital flight and reserves, because when these variables are affected, then there is less left over for the government budget. In addition, aid can affect imports and exports.[45]

White and Dijkstra (2003) examined the macro-economic impact of programme aid in eight countries in the 1990s. They did not find evidence that other capital inflows had decreased, whereas in some countries, such as Vietnam and Uganda, private transfers and direct investment had actually increased. This was partly the result of aid. The five countries with a high debt burden – Mozambique, Uganda, Tanzania, Zambia and Nicaragua – proved to have used part of the aid for debt payments. Nevertheless, during this period a large portion of the debt service was not paid, while debt stocks increased. All eight countries used part of the aid to increase imports. The impact of aid on imports was the smallest in Vietnam and Cape Verde, however. In Bangladesh, Uganda and Nicaragua, the importance of aid for imports diminished over time.

There seems to be a strong relation between aid, particularly foreign borrowing, and capital flight (Ndikumana and Boyce 2003). Eighty per cent of all loans to low-income countries during the period 1970–1996 proved to have exited the countries again in the form of capital

45 Exports, for example, can suffer under the effects of the 'Dutch disease'. These effects of aid will be discussed in chapter 6 in the context of budget support's impact on economic growth.

flight. These were all heavily indebted low-income countries. A recent study containing data until 2008 by the same authors shows that 60% of all incoming loans in Africa exit the country as capital flight (Ndikumana and Boyce 2011). This study also argues that a high debt stock led to continuous capital flight.

Aiyar and Ruthbah (2008) examined the aid's absorption effect (the impact on the current account of the balance of payments) and its spending effect (impact on the government budget). They found a low absorption effect, while reserves did not increase either. This means that the lion's share of aid exited the country in the form of capital flight. At the same time, aid did seem to increase government spending. Also in the longer term, the spending effect was greater than the absorption effect (p. 15).

4.5.2 Internal balance, in particular government budget

According to various authors (e.g. Djankov et al. 2006), budget support often leads governments in recipient governments to levy less taxes. This has been examined in what is referred to as the 'fiscal response' literature (White 1992; White 1998). McGillivray and Morrissey (2001) summarised this literature. They indicated that older fiscal response models used from 1975 until the early 1990s have methodological limitations; in particular, they did not take into account aid's endogenous nature: governments can decide to use more or less of the committed aid. More recent studies that did take endogeneity into account show various outcomes: aid had a negative impact on tax revenue in Pakistan, whereas the effect was positive in Costa Rica and slightly negative in the Philippines. McGillivray and Morrissey believe that the negative results can be explained by the policy conditionality that came with aid during that period, which often caused revenue from *import* taxes to decrease because of a reduction of import tariffs.

Mavrotas (2005) concluded that aid to Uganda in the years 1980–1999 did not decrease tax revenue. This quantitative study also showed that programme aid results both in less borrowing by the government and higher spending. Empirical research covering the years 1970–2001 led Mavrotas and Ouattara (2007) to conclude that there is no evidence that programme aid results in less taxation or less commitment to actually levy taxes. They also concluded that project aid mainly increases capital expenditures and programme aid increases consumer spending. Another striking conclusion is that project aid would have more of a positive impact on budget discipline than programme aid. This conclusion is probably due to *reverse causality* (see also annex V), however, because countries with budget problems (certainly before 2000) were supported with programme aid.

Osei, Morrissey and Lloyd (2005) concluded that aid to Ghana during the period 1966–1998 resulted in less borrowing and higher expenditures. Tax revenue simultaneously increased. Machado (2010) developed a model for Nicaragua and concluded that aid during the period 1966–2004 had no impact on tax revenue; it mainly resulted in less borrowing by the government. Ruben and Pop (2010) did find a minor but significant *positive* impact of aid on tax revenue during the period 1990–2007.

Cassimon and Van Campenhout (2008) examined the macro-economic effects of debt relief as a result of the HIPC initiative, as well as the effect of project aid and programme aid in 24 African countries. The effects of these forms of aid on tax revenue, government investment and borrowing in the domestic capital market are weak and hardly significant, but debt relief, and to a lesser extent aid, had the greatest effect on lowering the borrowing on the domestic capital market.

In a more recent review of studies about the relationship between aid and taxes, Carter (2010) concluded that actually no inferences can be drawn about the causal effect of aid on the structure of the tax system. Studies usually do not take into account that aid increases economic activity, so the tax revenue/GDP split could narrow as a result of the denominator effect. This does not tell us anything about the impact of aid on the tax regime, however. This author argued that case studies could enhance our understanding of aid's impact on the tax system.

White and Dijkstra (2003) concluded that programme aid did not result in lower tax revenue in any of the eight case study countries. In fact, tax revenue increased in many countries (Uganda, Tanzania, Vietnam and Zambia). Higher tax revenue can be the result of conditionality and/or technical assistance. They also concluded that programme aid played a role in widening the base for tax revenue by making more import and more production possible.

Aid, and balance of payments support in particular, also played an important role in curbing inflation. In the early 1990s, a number of these countries (Mozambique, Nicaragua and Uganda) were what we would call fragile states today: they had just emerged from civil wars and were both politically and economically unstable. The governments of Ghana and Tanzania also faced massive deficits during this time. Programme aid was extremely important in these five countries to finance necessary government expenditures without allowing inflation to rise. This also became clear in Uganda in 1992, when the suspension of programme aid directly caused inflation to rise. The greater economic activity that resulted from programme aid also helped to reduce inflation. And programme aid resulted in larger reserves, which made it possible, in turn, for the exchange rate to be a 'nominal anchor'.

The joint DAC evaluation of budget support in eight countries during the period 1999–2005 concluded that the modality has generally contributed to maintaining macro-economic stability by helping to finance government expenditures. But this stability was threatened by budget support's lack of predictability in Malawi and Nicaragua: donors suspended support as a result of these countries not meeting the conditions of the IMF programme. Unpredictability resulted in additional domestic borrowing in Mozambique and Rwanda *within* a fiscal year. This problem was set off in Uganda by eating into reserves. The Ministry of Finance generally combined budget support with increased borrowing on the domestic capital market in order to neutralise the impact of aid on the exchange rate. In all three countries, domestic interest rates rose, which had a negative impact on domestic investment (IDD and Associates 2006: 67).

This evaluation also concluded that tax revenue did not decrease as a result of budget support – in fact in many countries it increased. But budget support did make it easier for Uganda, for example, to dispense with an important local tax. Even though this was compensated for later by raising VAT and income taxes, it had a negative impact on local spending and also on local democratic accountability (IDD and Associates 2006).

4.5.3 Macro-economic impact in six countries

Our own country case studies confirm that there is no evidence that budget support caused tax revenue to decrease (table 4.6). Tax revenue increased in the six countries, partly due to economic growth, but also due to the conditions and technical assistance that came with budget support.

Table 4.6: Tax revenue as % of GDP in case study countries, at the beginning and end of budget support, or the last available year

	Beginning	End
Ghana 2000–2006	16	21
Mali 1999–2009	15	17
Nicaragua 2004–2008	16	18
Tanzania 2001–2008	10	15
Zambia 2006–2009*	16	15
Vietnam 2000–2004	17	21

* *Tax revenue decreased in Zambia in 2009 as a result of the economic crisis. In 2008, the figure was 17.5% of GDP.*

Source: For Ghana: Van Soest 2008; Mali: Lawson et al. 2011; Nicaragua: Dijkstra and Grigsby 2010; Tanzania: Nord et al. 2009); Zambia: De Kemp et al. 2011; Vietnam: IMF, Government Financial Statistics.

Most evaluations did not analyse whether budget support was used to build up international reserves. Based on evaluations, we conclude that some of the funds in Mali and Ghana were used to increase reserves or relieve domestic debt. Budget support funds increased spending in four of the five countries.[46] Nicaragua is an exception. An analysis of income, expenditure and deficit financing for this country shows that budget support was not used for additional expenditures but rather to relieve domestic debt. This is partly the result of the fact that most of the budget support was disbursed in the last quarter of the year.

[46] Vietnam is not included, see note in table 4.3.

Table 4.7: Macro-economic effects of budget support funds in the six countries						
	Ghana	Mali	Tanzania	Zambia	Nicaragua	Vietnam
Negative effect on taxes	No	Light/ No	No	No	No	Nee
Use of budget support funds:						
Increasing international reserves	Yes	Yes	No	No	?	*
Paying off domestic debt	Yes	Yes	No	No	Yes	*
Rising expenditures	After 2006	Yes	Yes	Yes	No	*

* *Budget support only constitutes 2% of government expenditure in Vietnam, so it is difficult to determine the effect of the funds.*

4.5.4 Cross-section results

In the 1990s, it was important to examine whether aid led to debt payments that otherwise would not have been made, because it regularly occurred that countries did not honour their debt payment obligations. But since the HIPC initiative was introduced, most countries that receive budget support are on schedule with their debt payments. Like the Independent Evaluation Office (of the IMF, IEO 2007), we assume that budget support does not have a direct effect on other capital inflows.[47] The only remaining 'leak' in the external balance then is that aid is used to increase reserves. In all other cases, the aid is 'absorbed' in the form of a greater current account deficit through increased imports (IEO 2007). The problem, however, is that there are other factors that may increase reserves, for example a change in the terms of trade. This is not included in the analysis below, however.

Apart from a potential effect on reserves, budget support can be used for expenditures, to lower taxes or reduce the deficit. We first analyse the effect of budget support on governments' budget balance. This concerns the balance excluding grants. Budget support and the government balance are measured as a percentage of the gross domestic product (GDP).

The government balance is probably also affected by the previous year's balance (positive), by economic growth (positive) and by income per capita of the population (negative). These variables are incorporated as controls, whereby, as usual, the logarithm of GDP per capita is included. All information, except that on budget support, comes from the World Bank's World Development Indicators (WDI). In addition, we include a variable that reflects the trend. Between 2002 and 2006 budget deficits first proved to decline in order, afterwards,

47 But these effects cannot be ruled out. As mentioned above, the rising inflow of private capital was an indirect effect of programme aid in the 1990s.

to rise again as a result of the global financial crisis. This trend variable therefore has a U-shaped development: deficits first decreased and subsequently increased.

Unfortunately, information about government balance excluding grants is only available for a limited number of countries. That is why we have also calculated the budget balances in which we only deduct the budget support grants (from the DAC CRS database) from the budget balance. The source for all data is the IMF's World Economic Outlook.

The estimates are *potentially* distorted by selection effects: countries receive budget support because they have a deficit or, conversely, do not receive budget support because their own budget is not in order. For this reason, we have also instrumented for budget support, whereby the size of budget support is estimated with the help of other exogenous variables (see annex V).

Table 4.8: Effect of budget support on the government balance (I)*

	Fixed effects			2SLS		
	Coefficient	t-value	Signif.	Coefficient	t-value	Signif.
GBS/GDP	-0.63	-3.24	***	-0.49	-2.47	**
Ln(GDP per capita)	3.32	1.42		5.23	2.51	**
GDP growth	0.12	2.75	***	0.12	2.35	**
Budget balance t-1	0.37	8.38	***	0.31	7.39	***
Trend**	0.91	5.51	***	0.87	5.24	***
Trend^2	-0.13	-6.64	***	-0.13	-6.27	***
Constant	-24.92	-1.59		-38.98	-2.74	***
R^2	0.36			0.22		
N	887			869		
Groups	101			100		

* *Excluding GBS grants.*

*** Trend: 2002=0, 2003=1, etc.*

*Significance levels: *p<10%; **p<5%; ***p<1% (based on robust standard errors).*

Source: OECD/DAC; IMF; WB/WDI; adapted by IOB.

As expected, budget support proves to be *negatively* related to budget balance (as mentioned, the balance excluding GBS grants) (table 4.8). The coefficient is -0.63, which would mean that additional budget support of 1% of GDP corresponds to an increase of the deficit of 0.63 percentage points. If tax revenue remains constant, this means that the effect of budget support on the reduction of the deficit (amortisation of domestic debt) and an increase of reserves will be approximately 0.4 percentage points of GDP. The control variables – economic growth, the previous year's balance and the income per capita of the population – are significant and have the expected sign.

The estimate with an instrumental variable gives a somewhat lower effect than the previous estimate (about 0.1 percentage points less), which suggests that budget support not only causes the primary deficit to increase, but also serves to limit the (expected) deficits.[48] The contribution to macro-economic stability is twofold, since aid:

- finances additional expenditures without running up domestic debt, and
- reduces deficits.

A specification that takes autocorrelation more into account, but is more sensitive to measurement errors, examines the relationship between the annual *change* in budget support and the *change* in the budget balance. A standard OLS regression, which includes growth and income per capita as controls, shows that an extra percentage point of budget support is converted into additional expenditures of 0.58 percentage points, on average (table 4.9). This effect is significant, but the uncertainty margins are large. On the basis of the average, and abstracting from fluctuations in tax revenue, it would mean that about 40% of budget support is used to increase reserves or reduce deficits. An estimate with an instrumental variable again generates a slightly lower coefficient of 52%.

Table 4.9: Effect of budget support on the government balance (II)*

	OLS			2SLS		
	Coefficient	t-value	Signif.	Coefficient	t-value	Signif.
BGS/GDP	-0.58	-3.97	***	-0.52	-2.49	**
GDP growth	0.12	4.10	***	0.14	4.24	***
Constant	-0.59	-2.77	***	-0.65	-2.94	***
R^2	0.04			0.04		
N	802			784		

* *Excluding GBS grants.*

*Significance levels: *p<10%; **p<5%; ***p<1% (based on robust standard errors).*

Source: OECD/DAC; IMF; WB/WDI; adapted by IOB.

Another way of examining how budget support is used is to look at the relationship between budget support and government expenditures. In countries with substantial budget support, government expenditures between 2000 and 2010 barely rose more than in countries without substantial budget support (table 4.10). The differences between countries are large, however. If we limit the analysis to the lower and lower-middle income countries, and omit countries with a population of less than one million inhabitants (because of a disproportionately large impact on the results), then

[48] Both estimates point to two different effects: if budget support is completely exogenous, this will result in either additional expenditures or a reduction of the deficit. However, budget support can also be endogenous, for example to reduce anticipated deficits in partner countries. Budget support, then, does not determine the size of the deficit but rather the opposite, namely the deficit determines the size of budget support. In that case, budget support is less likely to encourage additional expenditure. The lower value of the second estimate suggests that this effect does play a role.

government expenditures appear to have risen more in countries that received substantial budget support.

Table 4.10: Government expenditure as a % of GDP in countries with and without substantial budget support

	2000	2010	Difference
*Total:**			
No GBS (66 countries)	25.3	29.4	4.1
GBS (27 countries)	24.2	28.5	4.3
Selection:**			
No GBS (39 countries)	24.0	26.7	2.7
GBS (23 countries)	22.6	27.6	5.0

* *A country is classified as a GBS country if it received at least 0.25% of GDP and at least 2.5% of total aid as GBS between 2002 and 2010.*

** *Only lower- and middle-income with a population of at least one million inhabitants.*

This relationship is confirmed in a regression analysis with 'fixed effects' to check for country-specific differences. As control variable we also included a factor score of the six Kaufmann indicators, in addition to economic growth and income per capita (table 4.11). Good governance has a positive effect on government expenditures (significance level of 5%). The effect of economic growth is not significant, which is caused by the denominator effect: expenditure does increase. But it remains constant as a percentage of GDP (which, of course, also increases). Budget support has a positive and significant effect on expenditure. The coefficient shows that when budget support is increased by one percentage point of GDP, this goes hand in hand with increased expenditure of 0.59 percentage points. This would mean that 59% of each euro of budget support is spent. A specification that uses an instrumental variable (see chapter 1) results in a slightly higher estimate (with a coefficient of 0.62).

It is telling that there is little difference between the model with the balance as dependent variable and the model with budget expenditure as dependent variable. The effect on expenditures varies from 59% to 63%.

Table 4.11: The effect of budget support on government expenditure

	Fixed effects			2SLS		
	Coefficient	t-value	Signif.	Coefficient	t-value	Signif.
GBS/GDP	0.59	2.27	**	0.62	2.68	***
Ln(GDP per capita)	-1.23	-0.59		-2.45	-1.27	
GDP growth	-0.08	-1.68	*	-0.08	-1.51	
Expenditure t-1	0.61	14.72	***	0.60	14.14	***
Kaufmann score	1.77	2.43	**	1.83	2.54	**
Trend*	0.27	2.59	**	0.29	2.83	***
Constant	18.72	1.35		26.92	2.04	**
R^2	0.79			0.71		
N	866			848		
Groups	100			99		

*Significance levels: *p<10%; **p<5%; ***p<1% (based on robust standard errors).*

* *Trend: 2002=0, 2003=1, etc.*

Source: OECD/DAC; IMF; WB/WDI; adapted by IOB.

As far as government revenue is concerned, the conclusion is the same as for expenditures: they did not rise more in countries that received GBS than in countries that did not receive GBS (table 4.12). This is different when we limit the analysis to a smaller, more easily comparable group. But so far all government revenue has been included, including budget support and any other aid. It is therefore more interesting to focus exclusively on tax revenue.

Table 4.12: Government expenditures as % of GDP in countries with and without substantial budget support

	2000	2010	Difference
Total:			
No GBS (69 countries)	22.8	26.8	4.0
GBS (28 countries)*	21.0	25.1	4.1
Selection:**			
No GBS (40 countries)	20.1	24.0	3.1
GBS (24 countries)**	19.5	24.5	5.0
Tax revenue:			
No GBS (18 countries)	12.4	14.5	2.1
GBS (12 countries)**	15.3	19.4	4.1

* *A country is classified as a GBS country if it received at least 0.25% of GDP and at least 2.5% of total aid as GBS between 2002 and 2010.*

** *Only lower- and middle-income with a population of at least one million inhabitants.*

Less information is available about tax revenue. For this reason, the comparison has been limited to the years 2003 and 2008, since for these years information is available for relatively many countries. In this comparison, 12 countries with budget support had a larger increase in tax revenue as a percentage of GDP than 18 countries without budget support. The tax revenue of the first group amounted to 15.3% in 2003, as opposed to 12.4% for the second group. In 2008, these figures were 19.4% (an increase of 4.1 percentage points) and 14.5% (an increase of 2.1 percentage points), respectively. The number of countries is too limited, however, to generalise this conclusion.

We conducted a fixed effects regression in order to eliminate the potential influence of unobserved variables. Both the budget support in the same year, and that of the previous year, can have an effect, which is why we examined both. Control variables are economic growth, tax revenue from the previous year and the factor score of the Kaufmann indicators for good governance. As a result, we were able to control for potential selection bias: countries with good governance received more budget support but were therefore probably more able to increase tax revenue (see table 4.13).

Table 4.13: The effect of budget support on tax revenue (I)						
	Fixed effects			2SLS		
	Coefficient	t-value	Signif.	Coefficient	t-value	Signif.
GBS/GDP	0.15	1.16		-0.03	-0.25	
GDP growth	0.09	3.47	***	0.09	3.60	***
Taxes t-1	O.64	7.53	***	0.63	6.87	***
Kaufmann score	0.78	0.66		0.77	0.59	
Trend*	0.07	1.46		0.06	1.28	
Constant	4.80	3.82	***	5.06	3.86	***
R^2	0.92			0.92		
N	410			404		
Groups	70			70		

*Significance levels: *p<10%; **p<5%; ***p<1% (based on robust standard errors).*

* *Trend: 2002=0, 2003=1, etc.*

Source: OECD/DAC; IMF; WB/WDI; adapted by IOB.

Economic growth and tax revenue from the previous year indeed have a positive and significant effect on tax revenue, but good governance does not have a significant effect. This regression also suggests that budget support does not have a significant effect on tax revenue.

Using a standard OLS regression to analyse the impact of budget support on tax revenue, the effect also proves to be insignificant (table 4.14).[49]

Table 4.14: The effect of budget support on tax revenue (II)			
	Coefficient	t-value	Significance
ΔGBS/GDP	0.01	0.10	
Kaufmann	-0.06	-0.48	
GDP growth	0.08	3.18	***
Constant	-0.18	-0.96	

R^2=0.03; N=368.

*Significance levels: *p<10%; **p<5%; ***p<1% (based on robust standard errors).*

Source: OECD/DAC; IMF; WB/WDI; adapted by IOB.

49 The approach ensures stationarity. A disadvantage is a reduction of the signal-noise ratio, in general leading to higher standard errors. The coefficient is positive, which means that the chances of budget support increasing tax revenue are greater than the chances it would decrease. On the other hand, an analysis with an instrumental variable does not have a (non-significant) negative coefficient. The conclusion, therefore, is that there is no impact.

All in all, we can conclude that an additional increase of budget support by one percentage point of GDP results in increased government expenditures of about 0.6 percentage points of GDP in the same year. Tax revenue will probably not decrease. This means that on average countries spend about 0.4 percentage points of GDP to increase international reserves and/or amortisation of domestic debt. This means that the degree of macro-fungibility (see chapter 2) is limited: most budget support is used in the same year for which it is intended.

4.5.5 Military spending

One of the concerns with budget support is that it results in improper expenditures, including military spending. There is little evidence for this, however. For our analysis, we use available information from low-income and low middle-income countries. It appears that countries from this group with substantial budget support between 2000 and 2009 spend a little less on average on their military than countries without it, but the difference is not significant.[50] GBS countries with an increase (as % of GDP) include Tajikistan (1.0 percentage point), Armenia (0.6) and Malawi (0.5). Countries in the non-GBS group with an increase are: Morocco (1.0), Guinea (0.8) and Kyrgyzstan (0.7).

Table 4.15: Military expenditures as % of GDP in countries with and without substantial budget support

	2000	2009	Difference
As % of GDP:			
No GBS (37 countries)	3.1	2.5	-0.6
GBS (25 countries)	2.0	1.6	-0.4
As % of government expenditure:			
No GBS (29 countries)	11.1%	9.8%	-1.3%
GBS (19 countries)	11.1%	10.4%	-0.7%

* *A country is classified as a GBS country if it received at least 0.25% of GDP and at least 2.5% of total aid as GBS between 2002 and 2010. Excluding Georgia and Ethiopia.*

Military spending does seem high in many countries as a percentage of total government expenditure. This is especially true of Armenia (22%), Tajikistan (20%) and Burundi (18%). For countries without GBS, this is especially true of Kyrgyzstan (21%), Pakistan (18%) and Guinea (17%).

50 Georgia, Ethiopia and Sudan were omitted from this analysis due to extreme developments in these countries. Such extreme figures have a huge impact on averages. In Georgia, defence expenditures between 2000 and 2009 rose from 0.6% to 5.6% of GDP. In Ethiopia, the reverse is true, where expenditures decreased from 7.6% to1.3%. In Sudan, spending was high throughout this period because of the conflict situation.

Table 4.16 presents the results of a regression analysis, in which we examine budget support's relation with the size of military spending (as a percentage of GDP). This table does not show a significant impact either. There is great variation between countries, regardless of whether they did or did not receive budget support. This also means that donors did not succeed in limiting military spending in countries that received budget support. It should be noted that donor rarely pressed the issue, if at all.

Table 4.16: The impact of budget support on military expenditures (2002–2010)

	Fixed effects			Random effects		
	Coefficient	t-value	Signif.	Coefficient	t-value	Signif.
GBS/GDP	-0.05	-0.63		-0.05	-0.75	
GDP growth	-0.03	-1.80	*	-0.03	-1.70	*
Log GDP per capita	2.02	1.86	*	0.51	1.17	
Kaufmann score	-0.43	-1.59		-0.38	-1.54	
Trend*	-0.12	-2.23	**	-0.06	-2.09	**
Constant	-11.23	-1.55		-0.91	-0.31	
R^2 (within)	0.14			0.10		
N	649			649		
Groups	92			92		

Source: WDI, OECD/DAC; adapted by IOB.

*Significance levels: *p<10%; **p<5%; ***p<1% (based on robust standard errors).*

* *Trend: 2002=0, 2003=1, etc.*

Table 4.17 uses the development of military spending in Uganda as an example. Uganda received substantial budget support, but official figures suggest that military spending in this country did not increase much. Uganda also received extensive programme aid in the 1990s, but as a percentage of GDP expenditures were not higher than in many other countries. As is the case in many other developing countries, military spending was high as a percentage of government expenditure. A clear link with budget support is difficult to establish, so the question is whether military spending would have been lower in the absence of budget support. Chances are high that expenditures on education and health care, for example, would have been lower. But here too, donors did not succeed in pushing back military spending.

In this case, there is a huge snag, however. In 2010 Uganda bought a number of fighter jets from Russia at a price of US$ 740 million, about 4% of the country's GDP. The country used reserves of the Bank of Uganda to pay these jets. This purchase is not reflected in the data. It has been suggested that (expected) oil revenues played an important role. By then, the Netherlands had already decided to end sector budget support to the country because of changed policies in the Netherlands as well as a lack of progress in the education and the justice law and order sectors in Uganda.

Table 4.17: Military expenditures in Uganda as % of GDP and as % of government spending (2000–2010)

	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10
Expenditures (in billions of Ugandan shilling)	232	240	256	299	355	386	400	478	623	640	583
% GDP	2.5	2.3	2.4	2.4	2.3	2.4	2.2	2.3	2.5	2.1	1.7
As % of government expenditures	16	10.8	10.3	11.1	14.2	14.4	13.3	13.1	16.6	15.3	..
GBS as % of GDP*	..	..	1.5	2.0	1.4	0.9	2.7	1.1	0.5	0.8	0.9

* *Excluding sector budget support. According to an ODI publication (Hedger et al. 2010), sector budget support between 1999 and approximately 2008 constituted about 1/3 of general budget support.*

Source: WDI, OECD/DAC.

4.6 Transaction costs

4.6.1 Literature Review

Transaction costs are costs incurred when processing a transaction – an aid transaction in this case. They consist of preparation costs (information costs and search costs), negotiation costs and monitoring costs. The latter can be divided into costs for the recipient (called bonding) and costs for the donor (Hazeu 2000). One of the expected benefits of budget support is that the transaction costs would decrease, both for donors and recipients. This means more efficient aid, a larger portion of which can be used for its actual purpose.

An OECD survey conducted in 2002 asked recipients what they considered the three major burdens in their interaction with donors. 'Donor-driven priorities and systems' was mentioned most often, followed by 'difficulties with donor procedures' and 'uncoordinated donor practices' (Amis et al. 2005). If this is true, budget support could hugely economise on this 'burden'. The expected lower costs are in the first place a consequence of alignment of budget support: there are no separate project proposals, and no costs need to be incurred for implementing or monitoring projects. In the second place, they are the consequence of harmonisation: transaction costs are brought down as more donors spend more money through budget support, and as they increasingly use the same procedures.

Table 4.18 summarises the transaction costs of project aid and budget support.

Table 4.18: The transaction costs of project aid and budget support, for donor and recipient per type

	Project aid		Budget support	
	Donor	Recipient	Donor	Recipient
Information and searches	Set priorities at headquarters and in recipient country; preparatory missions	Identify potential projects, search for suitable donors	Determine criteria for GBS; assess PRSP quality; governance, PFM, macro-economic stability (for example via 'track records')	Examine donor criteria for GBS and try to meet them; e.g. make PRSP; negotiate about IMF agreement; accept technical assistance for PFM
Negotiations	Negotiate with recipient	Negotiate with donor	Discuss fundamental principles and performance matrices; between donors and with government	Discuss fundamental principles and performance matrices
Monitoring and bonding	Implement projects or monitor implementing bodies; monitoring by embassy; conducting evaluations	Report, monitor and audit as requested by donor	Prepare and attend meetings with budget support group; same for bi-annual or annual meetings with government	Write progress reports for bi-annual and annual meetings; attend these meeting; write progress report on PRSP

Source: Dijkstra and Grigsby (IOB 2010).

Most of these costs are salaries, but there are also material costs, such as meeting costs, travel expenses and paper. The problem is that people rarely, if ever, keep track of these costs. Another problem is that transaction costs should really be evaluated in relation to the ultimate impact of aid. That impact depends on the financial scope of the aid, but also on the quality. Yet in fact, transaction costs are generally incurred as a result of donors' attempts to improve aid effectiveness.[51] A comparison between transaction costs for project aid and programme aid (budget support) would therefore ideally compare the costs of realising aid transactions with the impact of these transactions. Because this is very difficult to do, transaction costs are usually expressed in relation to the size of financial resources. In our analysis of transaction costs in this report, we also compare transaction costs with the aid inputs, assuming that the effectiveness per euro of delivered aid is the same for all aid modalities.

[51] Paul and Vandeninden (2012) distinguish between net and gross transaction costs, whereby gross transaction costs are 'investments' in confidence, donor coordination and reduced fiduciary risk, for example.

Several studies argue that the transaction costs for budget support are too high. In particular with the launching of a harmonised system, budget support is associated with high transaction costs: search costs in the form of evaluating whether the recipient can handle budget support, and negotiation costs (Koeberle and Stavreski 2006). But it remains a labour-intensive system after that as well, due to the annual cycle of reporting (recipient), and discussing and assessing (donors) performance (IDD and Associates 2006, Lawson et al. 2007).

The transaction costs for budget support depend on the way in which discussions are organised and on the scope of the policy dialogue – in other words, on the number of sectors that are represented in the performance matrix. The more sectors there are in the performance matrix, the higher the transaction costs will be, in principle. The brief harmonised budget support programme in Bolivia (2004–2005) set an example in this respect: in addition to indicators for macro-economic stability, a PRSP and the share of expenditures on poverty, there was only one sector represented, namely PFM (Dijkstra 2005). The number of sectors was much greater in all the other countries for which we have seen performance matrices. Often, sector groups are created in which both a sector ministry and donors who are closely involved in the sector participate. They discuss which indicators to include and the progress on these indicators.

But more relevant questions are whether the transaction costs of aid have increased or decreased since budget support was introduced, and whether these costs are less than with project aid. These two questions are not the same. In answering the first question, people often assume that there was a shift in the early 2000s from project aid to budget support. This is not, or barely, the case. As shown above, in the early 2000s there was mainly a shift from other forms of programme aid (balance of payments support and debt relief) to budget support, and not so much from project aid to budget support. If anything, the shift from balance of payments support to budget support has led to higher, not lower, transaction costs. Not only are International Financial Institutions involved in the policy dialogue on budget support, but so are all participating donors. Moreover, the policy dialogue is now focused on many other aspects of government policy than only macro-economic policy, privatisation and the liberalisation of trade and prices.

Seen in this light, it is understandable that many studies conclude that transaction costs have not decreased much with the introduction of budget support. They observe that the amount of project aid and sector support has not decreased after budget support, and that transaction costs have been added on the recipients' end, namely for the body that coordinates budget support: ministries of finance and planning. The transaction costs for the sector ministries have not visibly decreased (Lawson et al. 2005, Lawson et al. 2007, Killick 2004).

Since there are hardly any other forms of programme aid anymore, the second question, about the difference in transaction costs between project aid and budget support, seems the most relevant one now. There are indications that the costs of budget support are lower. Even if the transaction costs related to budget support negotiations are high, recipient

countries have noticed that the transaction costs during implementation have decreased because the standard government procedures can be used (IDD and Associates 2006: S5). Donors observe that they could not have increased aid to the same extent without budget support. This was true, for example, in Rwanda (IDD and Associates 2006) and for DfID in many countries (National Audit Office 2008). The Ghana evaluation concluded that the transaction costs for budget support were lower than for 'other modalities' (Lawson et al. 2007). The World Bank only needed half of the transaction costs per dollar of aid for the PRSC than it needed for projects in Uganda (Miovic 2004, quoted in IDD and Associates: 52). In a 2005 study on PRSCs, the World Bank concludes that for each dollar of preparation costs, US$142 could be spent on budget support, as opposed to US$32 for other modalities (in NAO 2008). An estimate of four types of transaction costs in Nicaragua does suggest that they are usually higher than for an average project, but per dollar of delivered aid they were certainly lower between 2005 and 2009, both for donors and recipients (Dijkstra and Grigsby 2010). For the World Bank, participation in joint donor systems for budget support means that the transaction costs will increase compared to a situation in which the World Bank acts on its own (IEG 2010). But for the recipient country the opposite is probably true, at least if there are more donors providing budget support.

Bigsten et al. (2011) use data collected by Sida for the year 2010 about various kinds of administration costs: a) developing policy documents, b) implementing policy for development cooperation, c) collaboration and consulting, both national and international, and d) management, guidance and support. These costs are kept track of separately for various aid modalities. Table 4.19 has been compiled based on these data.

Table 4.19: Transaction costs per aid modality in Sweden

	Administration costs per Swedish krona spent	Administration costs in relation to project aid (%)
Programme-based aid	3.8	33
Budget support	2.2	19
Technical assistance	5.2	46
Project aid	11.3	100
Total	6.5	57

Source: Bigsten et al. 2011, p. 79

The average administration cost per Swedish krona spent was 6.5%, but the costs for project aid were much higher than for programme-based aid modalities (column 1). The second column shows that the transaction costs for budget support were only 19% of those for project aid. These data are only available for Sweden, but there is no reason to assume that this would be much different with other donors.[52]

[52] Easterly and Pfutze (2008) have made an estimate of the administration costs in relation to the total aid budget per donor. For bilateral donors they arrive at an average of 7%, and the average for multilateral donors is 12%. 6.5% for Sweden is close to the average of 7%.

4.6.2 Transaction costs in six countries

Whether transaction costs decreased after the introduction of budget support has not been analysed for all six countries. The conclusion for Ghana is that transaction costs for the government have decreased, but not for donors. The work of donors has changed, not decreased. But it seems that this conclusion does not take the increasing volume of aid into account. The transaction costs for every euro spent have presumably decreased for donors as well. It has been noted that transaction costs are still high in Tanzania, partly due to the emergence of new donors there, such as China, as well as the vertical funds. The conclusion for Nicaragua and Vietnam is that transaction costs for budget support are lower than for project aid, both for the governments and donors.

4.7 Conclusions

Over the long term, programme aid had not increased since 2000. Between 1986 and 1993, during the glory days of structural adjustment programmes, programme aid comprised about 10% of total (bilateral) aid, while between 2000 and 2010 it was between 3% and 4%. This percentage was much higher in some countries, however. In our six case study countries, the share of programme aid in total aid varied between 10% (Vietnam) and 42% (Tanzania).

The predictability of budget support varied strongly from country to country and from period to period, but it was not always better than with project aid. A great deal of budget support, moreover, was disbursed at the end of the year, which often resulted in expensive domestic borrowing. In African countries, including our four African case studies, predictability did improve over time. A study by Celasun and Walliser (2006) shows that the greater the differences are between commitments and actual disbursements, the fewer budget support funds are used for additional expenditures: in such cases, it is much more likely that domestic debt increases or reduces. When there are fewer actual disbursements, government investment decreases as well, but the opposite is not true.

In at least three of the six case study countries, part of the budget support was used to increase domestic reserves or pay off domestic debt (Ghana, Mali and Nicaragua). It appears that almost all of Nicaragua's budget support was used for this, partly because all funds were disbursed in the last quarter. In four other countries, government expenditure increased as a result of budget support. In Vietnam, budget support was too small compared to the government budget to determine whether it had an impact.

Our own cross-section analyses of budget support's impact on the internal balance show that every additional 1 percentage point of budget support (in % of GDP) leads to an increase in government expenditure of about 0.6 percentage points of GDP. There was no statistically significant impact on tax revenue. We can conclude with a fairly high degree of certainty that budget support did not cause tax revenue to decrease. This conclusion corresponds with other literature in this area. We can also conclude that the lion's share of budget

support funds were used for what they were intended, namely additional government expenditure. A smaller share was used to increase reserves or reduce domestic debt.

The transaction costs for each euro of aid were considerably lower for budget support than project aid, but higher than for older or other forms of programme aid, such as balance of payments support and debt relief.

5

Influencing policy and governance

5.1 Introduction

This chapter analyses whether donors have been able to use GBS to influence recipient countries' policies and governance. As discussed in chapter 2, influence is not only one of budget support's two inputs, but attempts to influence policy and governance have become one of budget support's second objectives, in addition to poverty reduction.

The degree to which donors try to influence recipient countries' policies and governance may depend on the application of selection criteria. The more donor and recipient preferences converge, the less need there is to influence the direction of policies of recipient countries. That is why this chapter begins with an analysis of donors' selection criteria and the degree to which these have been met. In theory, setting entry conditions is a way of trying to exert influence. The rest of this chapter discusses the process of exerting influence and the content of the agreements that emerge from the policy dialogue, and the results of attempts to exert influence.

Although this chapter is primarily about the potentially *positive* influence of budget support on changes to policy and governance, there is also literature that argues and examines that aid in general has a negative impact on democratic institutions. This literature is discussed in the next section.

5.2 Aid and good governance

5.2.1 The role of the state

Budget support is aid to governments. Some argue that this modality is primarily used to keep inefficient governments up and running, the idea being that governments are already big enough as it is. But generally the role a government plays in the economy increases with the level of development. An increasing complexity of an economy requires a stronger role of government. In this case, the government will also plays a greater role in creating social services, including a social income safety net in the form of social security. Seen in this light, one can easily justify aid leading to a somewhat bigger government: low-income countries are given the opportunity to develop their social and physical infrastructures somewhat, which can be used to encourage development.

In the (four) analysed African country case studies, total government expenditure is lower than the average in sub-Saharan Africa and also lower than the averages in all other regions in the world, with the exception of industrialised Asia (table 5.1). The substantial increase in government expenditure in Tanzania, a country that received a relatively large amount of budget support, is especially striking. Government expenditure in Zambia decreased slightly, which was the result of lower foreign and especially domestic interest charges (Whitworth 2010).

Government expenditure in Nicaragua is slightly above the average in sub-Saharan Africa, but equal to the rest of its region. Government expenditure in the Netherlands is 50% of GDP (IMF, World Economic Outlook 2012).

Table 5.1: Government expenditure as % of GDP in 2000 and 2010, case study countries and averages per region

	2000	2010
Ghana	20	24
Mali	22	23
Nicaragua*	34	34
Tanzania	15	28
Zambia	24	23
Sub-Saharan African	26	30
Latin America and the Caribbean	27	34
Middle East and North Africa**	31	34
Industrialised Asia	20	21
Central and Eastern Europe**	43	40
European Union	45	50

** 2001; ** 2002*

Source: IMF, World Economic Outlook 2012.

5.2.2 Aid and good governance: literature review

Authors such as Moyo (2009) and Boekestijn (2009) emphasize that aid to governments not only creates less incentive to collect taxes (discussed in the previous chapter), but also results in less democracy. If governments are mainly accountable to donors, then they may be less accountable to their own people and parliaments (see also Sogge 2002; Moss et al. 2006). This frustrates attempts to build a democratic state. Goldsmith (2001) examined this effect in African countries during the period 1975–1997. He concluded that aid had a positive impact on democratic developments, as measured on Freedom House's freedom index. Djankov et al. (2005) used the Polity IV index for 108 countries and inferred that aid had a negative effect on democracy during the period 1960–1999. More recently, Kalyvitis and Vlachaki (2012) also concluded that aid has a negative impact on democracy. They studied the period 1967–2002. The effect is greater if there was already little democracy in the country.

It can be said, however, that aid played a role in the Cold War in many of the researched periods, and it was mainly granted for strategic reasons. It often concerned authoritarian leaders who became even less democratic over time. Dunning (2004) examined the impact of the Cold War by reusing Goldsmith's (2001) data but this time comparing two periods: 1975–1987 and 1988–1997. The author concluded that there was no significant effect of aid on democratic development before 1987, but this relation was significant for the second period. Dunning argues that the Soviet Union's influence in Africa was already on the wane in 1987, and that had changed western donors' attitudes too. After 1987, donors began placing more emphasis on political conditionality and that became more credible as well.

Dutta et al. (2011) observed that there is no consensus on the impact of aid on democracy, and they suggested a different hypothesis: aid promotes democracy in countries that are already democratic, but the opposite is true in countries that already display dictatorial traits. The researchers analysed the period 1960–2009 in 124 countries using the Polity IV index, and the results confirm their hypothesis. The authors concluded that aid can reinforce certain paths (amplification effect), but cannot put a country on another path.

Several studies have examined the relationship between aid and other governance aspects. No consistent outcomes emerged for the relationship between aid and corruption. Some concluded that aid increases corruption (Alesina and Weder 2002), while others argued that corruption decreases thanks to aid (Tavares 2003). The findings by Knack (2001) and Bräutigam and Knack (2004) suggest that aid has adversely affected the quality of governance. They looked at the change in the International Country Risk Guide (ICRG), respectively for the periods 1982–1995 and 1982–1997 and only for 32 African countries. Rajan and Subramanian (2007) concluded in a more indirect way that aid results in poorer governance by showing that aid has a negative impact on growth in industrial sectors that depend on the quality of governance. They found this to be true for the period 1981–1990.

Busse and Gröning (2009) examined the impact of aid on change in the ICRG for 106 countries and for the period 1984–2004. They found a small but significant negative impact. They instrumented for aid with the GMM (General Method of Moments) method. While the period they focused on might be more recent, the authors themselves indicated that much aid during this period consisted of debt relief that did not increase the actual flow of funds and which was given in previous loans to countries with poor governance. Ear (2007) examined the effect of aid on the different Kaufmann indicators for the period 1996–2004. This is the period following the Cold War. This author does not find any significant effect; the coefficient for 'voice and accountability' is the most positive.

All in all, the outcomes of these empirical studies are not unequivocal about the effect of aid on democracy or institutions. There are as yet no quantitative empirical studies on, specifically, the impact of budget support on good governance. There are a number of reasons why budget support might have a greater positive impact on political good governance and also on the control of corruption. There is much emphasis with budget support on implementing more transparent budgeting and reporting of expenditures, which can also be used by parliament and civil society. Recipient governments also

implement all projects financed by budget support themselves. As a result, the link between the implementer and the ultimate client/user of the services is restored. These factors could lead recipient governments to improve accountability to their own people more than with project aid. Moreover, the policy dialogue and selection criteria could have an impact as well. The rest of this chapter examines these different kinds of possible effects of budget support.

5.3 The role of selection criteria

In the 1980s and 1990s, programme aid consisted mainly of balance of payments support, import support and debt relief. It was given in the context of structural adjustment loans by the IMF and the World Bank. For bilateral donors, the most important entry condition for this kind of aid was remaining 'on track' with the IMF programme or a joint IMF–World Bank structural adjustment programme (White and Dijkstra 2003: 19). After the fall of the Berlin Wall and the end of the Cold War, bilateral donors focused more on the political situation in recipient countries.[53] The violation of democratic or human rights was sufficient reason to decrease or end aid. In such cases, programme aid was more likely to be cut than project aid.

Not only did budget support have a different objective than balance of payments support, namely to contribute to more effective poverty reduction measures, but it was meant to encourage ownership in recipient countries as well. This led, among other things, to more and different entry conditions. The four groups of criteria most often applied require these countries to have:

- an approved poverty reduction strategy (PRSP);
- a stable macro-economy, often still operationalized as having an IMF programme;
- a minimum level of transparency and quality of public financial management (PFM); and
- good governance, with characteristics such as rule of law, respect for democracy and human rights and absence of corruption.

Donors consider these criteria necessary in order to achieve results with budget support. At the time, these entry criteria are important for domestic accountability to parliament and the people (Molenaers et al. 2010). It turned out to be increasingly difficult over time to defend budget support in countries where governance was below par. Democratic governance and human rights in particular gained importance: four of the five donors interviewed by Molenaers, Cepinskas and Jacobs in 2010 identified this as one of the conditions for budget support.

53 Western countries no longer supported dictators just to keep in them within the western sphere of influence.

The question is whether these four kinds of entry conditions are really so important for achieving results with budget support. Poverty reduction strategies are often set up to meet donor demands and reveal little about a government's real priorities. Moreover, it is generally impossible to develop long-term strategies that contain real choices *and* which are broadly supported *and* sufficiently concrete that they influence annual budgets (Dijkstra 2005, Woll 2008). Although a certain budgetary discipline is welcome, certain parts of IMF programmes can be questioned as well.[54] Focusing on a government's financial management can be positive, but donors often tend to propose overly complex reforms (Dorotinsky and Floyd, quoted in De Renzio, 2006). Good governance is not a prerequisite for socio-economic development (see chapter 2), but elements of it can be objectives in themselves. The only relevant criterion for providing budget support, according to Morrissey (2006), is that donor and recipient government agree on priorities regarding government expenditure (Morrissey 2006).

In practice, donors were lenient with these criteria at the start of budget support, as a study of three Latin American countries shows (Dijkstra 2005). It was usually enough for governments to voice their intention to improve governance or PFM, and even that did not always happen. A PRSP did not always have to be officially approved, as turned out to be the case in Bolivia in 2004. On the other hand, having a PRSP was not always sufficient on its own either. Honduras, for example, did not receive budget support. The presence of a group of bilateral donors advocating the new aid architecture as stipulated in the Paris Declaration also turned out to be important, and that was not the case in Honduras.[55]

Clist et al. (2011) have empirically examined the factors associated with budget support provided by the EU and the World Bank. The assumption was that the share of budget support in total aid depended on the degree of agreement on preferences between donors and recipients (measured as having a PRSP and the percentage of government expenditure on education), and the government's effectiveness. For donors, the existence of a PRSP proved to be an important criterion for granting budget support. Only the EU considered the percentage of expenditure going towards education an important factor for determining the amount of budget support. Government effectiveness as measured by the Kaufmann indicator did not turn out to be significant.

The requirements were not always met in our six countries at the start of budget support either (table 5.2).

54 See extensive publications that criticise the IMF's conditions (Chang 2007, Stiglitz 2002, Rodrik 2006, Wade 1998).

55 The country did receive budget support from the development banks (World Bank and IADB).

Table 5.2: Degree to which the six countries met the entry conditions

	Ghana	Mali	Tanzania	Zambia	Nicaragua	Vietnam
Year	**2003**	**2002**	**2002**	**2005/2006**	**2005**	**2002**
PFM, esp. transparency	Not very good, did implement some improve-ments	No, but improvement was expected	No, but improve-ment was expected	No, but improve-ment was expected	Yes, further improve-ment underway	No, but some progress
PRSP or commitment to poverty reduction	Yes, but doubts about PRSP quality	Has PRSP, but doubts about willingness to reform	Yes	Yes	Has PRSP, but doubts about commit-ment	Yes
Good governance	Fairly well	Yes, democratic, but doubts about corruption approach and women still had few rights	Confidence in government	Confidence in control of corruption	No, but executive authority has intention	No
Institutional capacity	reasonable	moderate	reasonable	moderate	reasonable (?)	good
IMF or stable macro-economy	Yes	Yes	Yes	Yes	Yes	Yes

Source: Our own assessment based on the country case studies and the sources used for the country case studies.

All countries had an agreement with the IMF and an approved PRSP at the start of budget support. But donors were not always enthusiastic about the quality of the strategy or the degree of ownership. The Nicaraguan government did develop a strategy, but a section on social sectors was only incorporated after incessant insistence by donors, and poverty reduction was not a priority. Donors also had doubts about the Malian government's willingness to reform, which contributed to the fact that the Netherlands, for example, disbursed budget support through the World Bank for some years. Governments' financial management was sub-par everywhere, but most countries expressed the intention to improve it. Ghana met the criterion for good governance the best, but not all elements were satisfied there either. Donors were confident that the governments of Nicaragua, Tanzania and Zambia were moving towards democracy and intended to fight corruption at the start of budget support. There were no visible plans whatsoever to improve governance in Vietnam.

The World Bank's Country Policy and Institutional Assessment (CPIA) often played an important part in evaluating good policy and governance. There are no CPIA scores available for the years preceding 2005, but there are rankings for 2003 (the average year in which budget support began in the six countries): countries can be in a specific quintile for the four components. The first quintile (1) contains countries with the best results, whereas the fifth quintile (5) contains those with the lowest scores. In addition, the CPIA classifies good governance separately (according to the same scoring method). Tanzania scored fairly well in all components in 2003, as did Nicaragua and Ghana, except in economic management (table 5.3).

Table 5.3: CPIA scores (quintiles) 2003

Cluster	A	B	C	D	IDA Governance	Overall
Ghana	3	2	2	1	1	2
Mali	1	3	3	2	3	2
Nicaragua	3	1	1	1	2	1
Tanzania	1	2	1	1	1	1
Vietnam	1	4	1	3	4	1
Zambia	4	2	3	2	3	3

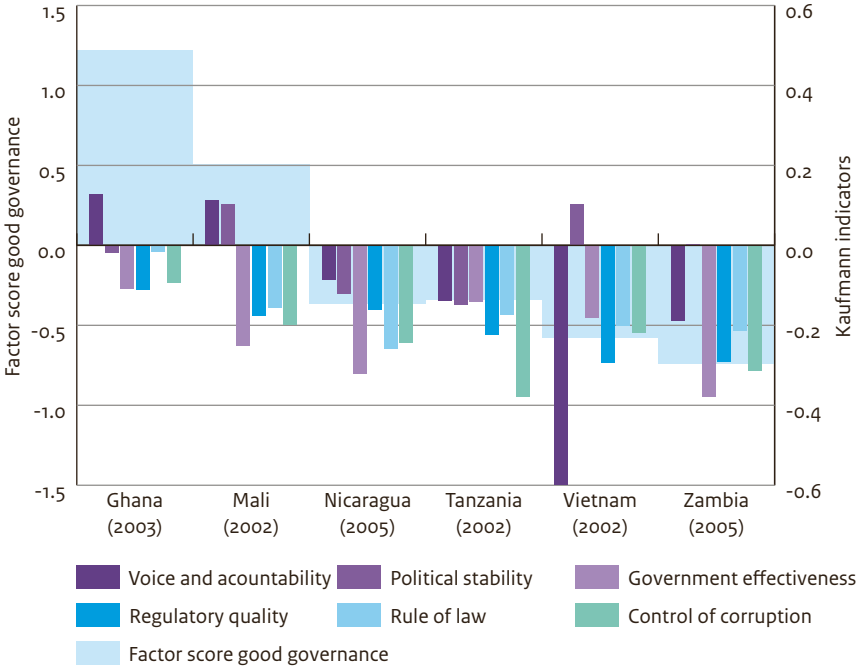
Source: World Bank

A. Economic management; B. Structural policies; C. Policies for social inclusion/equity; D. Public sector management and institutions.

Figure 5.1 shows the values of the six Kaufmann indicators for good governance (Worldwide Governance Indicators composed by Kaufmann, Kraay and Mastruzzi)[56] for all six countries at the start of budget support, as well as a factor score based on these six indicators. The year 2002 is used for Mali, Tanzania and Vietnam, while 2003 is used for Ghana and 2005 for Nicaragua and Zambia (see also table 5.2). Figure 5.1 confirms that Ghana was in the best position at the start of budget support in terms of governance. Mali also had a positive overall score, but did less well in the areas of government effectiveness and control of corruption. In Vietnam, democracy (voice and accountability) was in poor shape, as expected, and the country also scored fairly badly on the other good governance indicators – about the same as Nicaragua, Tanzania and Zambia.

[56] See http://info.worldbank.org/governance/wgi/index.asp.

Figure 5.1: *Kaufmann indicators when budget support started in the six countries*



Note: See chapter 1 for an explanation of how the factor score for good governance is calculated.

Looking at all lower and lower middle-income countries, there does not seem to be a correlation between budget support received as a percentage of GDP (between 2002 and 2010) and the scores on the Kaufmann indicators in the year 2000 (table 5.4). There is, with the exception of regulatory quality, no significant relationship. Good governance (as expressed by the Kaufmann indicators) was apparently not a deciding criterion for granting budget support (see chapter 3 for an analysis of the Netherlands).

Table 5.4: Correlation coefficients between budget support received between 2002 and 2010 and scores on the Kaufmann indicators in 2000

	% of GDP	% of ODA	
Voice and accountability	-0.00	0.22	
Political stability	-0.05	0.16	
Government effectiveness	-0.11	0.16	
Regulatory quality	0.00	0.24	*
Rule of law	-0.10	0.13	
Control of corruption	0.03	0.14	
Factor score for good governance	0.05	0.21	

* *Measured as a % of GDP and as % of ODA*

* *Significant at 5% level.*

There is a strong relationship between receiving substantial budget support and reaching the Decision Point of the HIPC initiative at an early stage (before 2003 – see table 5.5).[57] Of the 21 countries that reached the Decision Point before 2003, 16 were to receive budget support. Exceptions were Ethiopia, Bolivia, Gambia, Honduras and Mauritania, though these countries did receive some budget support. Of the 27 countries that received substantial budget support, 11 did not qualify for HIPC or reached the Decision Point later.[58] Countries that reached the HIPC Decision Point early had a considerable degree of macro-economic stability and had developed a poverty reduction strategy – two important conditions for general budget support. But the close relation shows that donor decisions display a certain degree of path dependency as well.

Table 5.5: Relation between HIPC Decision Point and budget support

HIPC/ABS*	No	Yes	Total
No	37	12	49
Yes	5	16	21
Total	42	28	70

* *Yes to HIPC = Decision Point reached before 2003;*

Countries considered 'GBS': countries that received GBS of at least 0.25% of GDP and at least 2.5% of ODA between 2002 and 2010. The group of 70 entails low-income countries and lower middle-income countries with at least 1 million inhabitants – except India (large population), Afghanistan and Iraq (special situation).

Source: Own elaboration on the basis of data from OECD–DAC on budget support, HIPC Decision Point data from the IMF and the World Bank, 'Status of Implementation of HIPC/MDRI', September 2010, p. 17.

[57] Pearson's chi-square =16.4 (p<1%).

[58] These countries include Armenia, Burundi, Central African Republic, Georgia, Guinea Bissau, Laos, Lesotho, Moldova, Tajikistan, East Timor, Togo and Vietnam.

5.4 Conditionality and influence

The policy conditions in the structural adjustment programmes of the World Bank and the IMF were aimed at improving macro-economic stability and increasing growth, for example by means of liberalising trade and reducing the government deficit. Setting up these conditions and conducting the policy dialogue with recipient countries was an IMF and World Bank task. A major difference with budget support is that the bilateral donors now do 'have a say' in the dialogue with recipient countries. Another difference is the conditions themselves. Macro-economic stability and economic reform are still part of them, but many other issues have been added.

Bilateral donors usually took the initiative for setting up a joint system of budget support, and tried to get the World Bank, other regional development banks and the EU to join them. These joint agreements between donors and recipient governments usually consisted of three components:

- agreements on procedures: when and how often to report; how often to discuss reports together; when to make commitments and disbursements;
- agreements on a number of principles to which donors and recipients will adhere to, often referred to as underlying principles (UPs); and;
- agreements on the policies to be implemented or the policy results to be achieved, often in the form of a Performance Assessment Framework (PAF).

The 'underlying principles' usually reflect the entry conditions. They encompass the implementation of a policy aimed at macro-economic stability, dedication to poverty reduction and elements of the 'good governance' agenda, such as controlling corruption, transparent government finances, an independent judiciary, freedom of press, and free and fair elections. Donors reserve the right to suspend budget support when one of these conditions is not met. But, as described above, not all the underlying principles had been met at the start of budget support, and so it was not clear where donors were going to draw the line.

It is precisely because the preferences of donors and recipients were not exactly the same at the start of budget support that donors tried to exert influence through the PAF and an annual or biannual discussion on the progress of the PAF. Often, PRSPs were not enough to base the PAF on, and this resulted in the policy dialogue being dominated by too many specific donor priorities (Knoll 2008).

Since most countries that received budget support had been admitted to the HIPC Decision Point, they already had a poverty reduction strategy and essentially there was agreement about a priority for poverty reduction. But this consensus was sometimes appearance and frequently limited to technocrats from ministries of finance of recipient countries (Whitfield 2009). In reality, donors began to interfere in many details of government policies under the rhetoric of 'partnership', 'harmonisation' and 'alignment'. Recipient governments' dependency on aid and budget support in particular meant they agreed to have sector working groups in which the donors played an important role (there were 29 in

Mozambique). According to Whitfield, donors determined the agenda in many countries in sub-Saharan Africa, including Ghana, Mali, Mozambique, Tanzania and Zambia. In Botswana, the government acted with more independence vis-à-vis donors, and Ethiopia and Rwanda took a position in the middle (Whitfield 2009).

The nature of the indicators says something about the way in which and the degree to which donors thought they could exert influence. The following features give us an idea of this:

- *The number of actions and indicators in the PAF*: a higher number can point to both the feeling that there is a greater need to exert influence but also to a lack of donor harmonisation or abundant space for sector experts. The number of indicators was very high in many countries. In Zambia, donors recently succeeded in substantially reducing the number.
- *The degree to which actions and indicators had to be implemented by different actors within governments*: sometimes this was limited to ministries of finance and/or planning, sector ministries and local governments, but sometimes actions were also expected from state institutions upon which the executive authority had little influence, such as the judiciary or parliament.
- *To what extent are the indicators based on the recipients' plans and priorities?* The more this is the case, the more confidence donors apparently have in recipient governments and the less influence is considered necessary (Alonso et al. 2006).
- *What is the share of process indicators (measures or actions) relative to that of result indicators (the results aimed for) in total?* Banks generally prefer output or process indicators, whereas bilateral donors prefer results (outcome) indicators. Results indicators essentially give recipients more policy leeway, and hence more ownership (Adam et al. 2004; Dijkstra 2005; Gunning 2006). One problem with results indicators is that governments cannot always exert influence on them, especially if they are defined at outcome or impact level. Getting reliable annual data is often a problem as well.
- *To what extent do recipients really have to meet these indicators; in other words, how much do 'prior actions' and 'triggers' count towards the total?* Donors use prior actions and triggers to influence specific actions or outcomes; other indicators are only broadly assessed against progress.
- *Do triggers and prior actions determine the total amount of a donor's disbursements, or are there also variable tranches?* Donors use variable tranches to reward the level of performance: because it is not an 'all or nothing' response, the chances that donor actually use this are greater, and influence can be exerted in this manner. On the other hand, variable tranches go against the idea of ownership, and they can compete amongst each other or with the remaining indicators, thereby rendering the agreed upon incentive system less coherent.

Although donors reach joint agreements, in principle, they sometimes prefer different types of indicators, and not all donors use prior actions, triggers and variable tranches. The World Bank has a strong preference for process indicators and always has its own prior actions (for one-year loans) and triggers (for long-term loans). Over time, the number of real conditions (prior actions and triggers) has decreased, from 35 in the late 1980s to 12 in 2005 (Koeberle and Walliser 2006: 272). At the same time, the number of 'benchmarks' increased. This was still the trend in more recent years: the total number of conditions remained the same, but the share of triggers and 'prior actions' declined (IEG 2010).

The European Commission and many bilateral donors prefer results indicators. The European Commission uses a system of fixed and variable tranches (Adam et al. 2004). There are a number of hard conditions for the fixed tranche in the area of fundamental principles, supplemented with sector-specific conditions in the case of sector budget support. The amount that is disbursed in the variable tranche depends on the results. Depending on the performance, 0%, 50% or 100% of the tranche is disbursed. The aim of incorporating result indicators was to promote ownership and a drive to achieve results. The European Commission's MDG contracts, which have a term of six years, are an example. It is not always possible to make a valid and reliable measurement of the different indicators, however, and governments often do not have much influence on them in the short term. This also makes it difficult to link sanctions to the failure to meet objectives (Adam et al. 2004; De Kemp et al. 2011).

Looking at the PAFs in the six countries, there were always indicators related to macro-economic stability, reform of the PFM system and other reforms in the area of good governance. In short, the underlying principles were also crystallised in the PAF. An increase in poverty expenditure as a percentage of the total budget was also usually part of the PAF.[59] Moreover, there were indicators in all countries for many other sectors and government institutions. The number of sectors with indicators in Vietnam, 17 in the end, increased in parallel with the number of participating donor countries. Every donor had its own sector priorities in each of the countries, but taken together it generated an extensive matrix with many detailed indicators. Donors tried to steer recipient governments to the detail (micromanagement).

The degree of agreement in preferences also varied (table 5.6). The only indicators incorporated for Vietnam were those that the government agreed with. Initially, the indicators for Nicaragua were enforced by donors, but this changed after a new government took power. The Ghanaian government agreed as well, but it turned out to have completely different priorities when it was allowed to choose itself how to spend US Millennium Challenge Account resources. The PAFs in Mali, Tanzania and Zambia were officially based on poverty reduction strategies, but in practice, donors added many things to this list, so they had considerable influence on the framework.

Almost all PAFs contain a mixture of process and results indicators, but process indicators are in the majority. In Vietnam, a few results indicators were incorporated from 2006 onwards only. Many results indicators have one or more of the anticipated shortcomings: not very relevant, governments cannot fully influence them, not very reliable or no annual data available. In Ghana, all donors used variable tranches, but this only had consequences for the volume of disbursements on one occasion. Barely any variable tranches were used in most other countries, if at all. In Tanzania and Zambia, donors kept careful track of which percentage of the indicators was being met. Of course, this is not such a good gauge of

59 The definition of what poverty reduction expenditures are varied considerably from country to country and sometimes changed in the course of time.

how a government has performed, because one indicator is more important and/or more difficult to achieve than another.

Donors have become more critical over time about honouring the underlying principles. Especially from 2007 onwards, they began to withhold budget support because of corruption or the failure to respect democratic or human rights. Sometimes the situation in a country changed (such as Nicaragua), but more often than not, they had been dissatisfied with the governance situation for a while but were suddenly given a clear reason to cancel support (such as in Zambia). In these two countries, donors failed to harmonise sufficiently.

Table 5.6: Characteristics of PAFs in the six countries

	Ghana	Mali	
Number of donors	9 to13	9	
UP:			
Agreement on preferences	Yes, initially on IMF only	Partially	
Complied with	Well	Partially	
Sanctions applied	No	No	
Harmonisation of sanctions	n/a	n/a	
PAF:			
Agreement on preferences	+/-	Little	
Complied with	For the most part	Partially	
Sanctions applied	Yes, in '06 and '08	(2009: 14 realised; 9 partially; 11 no)	
Harmonisation of sanctions	Yes in '06 not in '08	No	
Process indicators	34–43	n/a	
Executive power can influence	Yes	29–31*	
Result indicators	12	Partially	
Government can influence	Partially	5–8	
Relevant	Partially	Partially	
Reliable	Partially	Partially	
Annually available	Partially	Partially	
Prior actions, triggers	Yes	Partially	
Complied with	Yes	Yes	
Cuts imposed	n/a	Not always	
Variable tranches	11 donors	Yes, including EU	
Complied with	Usually	Partially	
Cuts imposed	Yes	Yes	

Source: Our own assessment based on the country case studies.

* *Mali works with separate 'triggers' (déclencheurs), under which fall different indicators in turn. In 2010 there were 39 triggers and 60 indicators. The triggers, however, are not triggers in the strict sense that disbursement of budget support depends on achieving them (which holds for the World Bank's triggers).*

	Tanzania	Zambia	Nicaragua	Vietnam
	14	9	7 to 9	3 to 14
	For the most part	At the beginning yes, less so later	Initially yes, later no	n/a
		Not entirely	No	n/a
	Unilaterally by the Netherlands	In 2009, only by Sweden	Yes from 2008 onwards	n/a
	No	No	No	n/a
	Reasonable	Reasonable	Initially yes, later no	Yes
	65% (2008)-86% (2007)	Decreasing from 70% ('06) to 56% ('09); 62% in 2010	Initially little, later for the most part	For the most part
	No	Yes (WB)	No	No
	n/a	No	n/a	n/a
	31–52	Yes (about 50%)12–20	37–95	Until '06 only; after that: majority
	Yes	Yes	+/-	
	16–33	13–21	28–66	Some from '06 onwards
	Partially	Partially	Partially	Partially
	Partially	Partially	Partially	?
	Partially	Partially	Partially	?
	Partially	Partially	Partially	?
	Yes	2 donors	3 donors	Yes
	Not always	No	Partially	Not always
	Yes	Yes	Yes	No
	Yes, various donors	5 donors	2 donors	No
	Usually	Partially	Partially	n/a
	Yes	Yes	Yes	n/a

5.5 Results of attempts to influence

Donors often use budget support to buy reforms. But the Paul Streeten (Streeten 1987) paradox still holds here. Why should donors try to buy good policy if this policy is good for the recipient country? If the policy is good, the recipient would be willing to pay for the advice. There are several potential solutions to this paradox:

1. The policy is not good for the recipient country: donors have the wrong ideas; a variation of this is that the policy is not good for the recipient but is in the donor's interest (that could be economic, for example, in the case of import liberalisation, or political, in the form of accountability to parliament or to a donor country's people);
2. The policy is on the whole good for the recipient country, but there are winners and losers; budget support can be used to 'buy' the losers' support;
3. The policy is good for the recipient country in the mid to long term, but has mainly losers in the short term; there is a 'collective action problem'. Donors can use budget support to help solve this problem.

Examples of all three can be found in the literature on conditionality in structural adjustment programmes in the 1980s and 1990s. Collective action problems mainly emerged when budget deficits were reduced in order to curb inflation: this was in everyone's interest, but concrete cutbacks were not. Donor pressure was able to help reduce the budget deficit (Van Donge and White 1999). The second scenario has occurred as well; there have been countries and situations in which conditionality was effective thanks to the resources that were available to win over initial opposition (Nicaragua in about 1994, see Dijkstra 2002). There are also examples of the first scenario: wrong conditions, too extensive conditions (reform is not always better for growth, see White and Dijkstra 2003), bad timing or sequence of policy conditions, etc. Donors sometimes admitted this in retrospect, but any damage ensuing from wrong policy advice was always borne by the recipient country.

The overriding conclusion in the literature from the 1980s and 1990s on policy conditionality is that setting conditions was not effective. Buying reform does not work; domestic political-economic factors determine whether reform is implemented (Collier et al. 1997, Dollar and Svensson 2000, Dijkstra 2002, Killick et al. 1998, Dollar et al. 2001). The lack of effectiveness is partly attributable to the fact that donors barely used sanctions; each donor has other objectives as well, and donors do not always agree with each other (Killick et al. 1998; Dijkstra 2002).

Donors have even less sway when they try to influence institutions and the quality of governance (Kapur 2001, Kapur and Webb 2000, Nelson 1996). Influencing political systems is rarely successful (Crawford 1997).[60] A few authors also showed theoretically that conditionality does not work: when donor and recipient preferences correspond, conditionality is irrelevant, and when that is not the case, it does not work (White and

[60] At least through aid to developing countries. The political conditionality for entry to the European Union has been reasonably successful.

Morrissey 1997). According to Cordella and Dell'Ariccia (2002), conditionality is not effective when the recipient's policy cannot be fully monitored. In practice, this is the case.

Results with budget support

As described above, Whitfield (2009) concludes that ownership has not increased in many African countries. African governments did allow donors to interfere in their policy during the 'partnership era', but the agreements were subsequently not implemented. So in fact not much has changed since the 1990s. Gould (2005) concludes from research done on Tanzania, Honduras and Vietnam that a huge gap emerged between policy on paper and implemented policy. Moreover, there was a gap between the technocratic policy discussions with donors and the world of politics. Domestic politics was still dominated by clientelism and ad hoc decision making.

In line with the outcome of earlier evaluations, the joint DAC evaluation of budget support concluded that local institutional factors are the most important for reform (IDD and Associates 2006). Donors support reform, but they cannot instigate far-reaching policy change or change in the political system. Donors seem to have had some influence in certain areas. Expenditures in the social sectors and/or expenditures on poverty reduction did increase in many countries as a result of the 'new conditionality' (Mosley et al. 2004; see also chapter 7). Budget support also seems to have sometimes influenced governments to improve their financial management (IDD and Associates 2006, Lawson et al. 2005, Lawson et al. 2007, Lawson et al. 2011, De Kemp et al. 2011). These evaluations often add, however, that improvements in PFM systems are partly the result of the technical assistance that came with GBS. According to Williamson (2006), improvements were already underway in Uganda and Tanzania before budget support was provided, and they cannot be attributed to the policy dialogue on budget support. Budget support often has a positive effect on the planning and budgetary processes in recipient countries, however: the coordinating role of the ministries of finance is strengthened, and the policy coordination between ministries is enhanced (De Renzio 2006). On the other hand, budget support did not make governments more accountable to domestic institutions such as parliament (De Renzio 2006, Morazan and Koch 2010). The World Bank evaluation of PRSCs concludes that this budget support has helped improve those aspects of financial management that are easier to tackle, such as budget classifications (IEG 2010). Governments did not always manage to bring all of their expenditures within the budget or to implement results-oriented budgets. The effect of budget support on corruption has not been analysed much, but there does not seem to be any evidence suggesting that budget support encourages more corruption than other modalities of aid (Tavakoli and Smith 2011).

Broadly speaking, these conclusions are also true for the six countries (table 5.7). Budget support has had a positive impact on PFM and on poverty reduction expenditures, but much less so on good governance or other aspects of governance or policy.[61] Governments were already convinced that macro-economic stability was needed, and this insight was also already widely shared. Budget support did result in more transparency in budgets

[61] As described above, the definition varied from country to country.

and reporting in Nicaragua, and that helped to improve domestic accountability in the first period. In Ghana and Mali, the business climate improved, but this was one of the government's priorities as well. More corruption was uncovered in Zambia, which was partly the result of better financial management and improved financial control (De Kemp et al. 2011). Donors were not able to significantly influence political processes or respect for human rights in a single country.

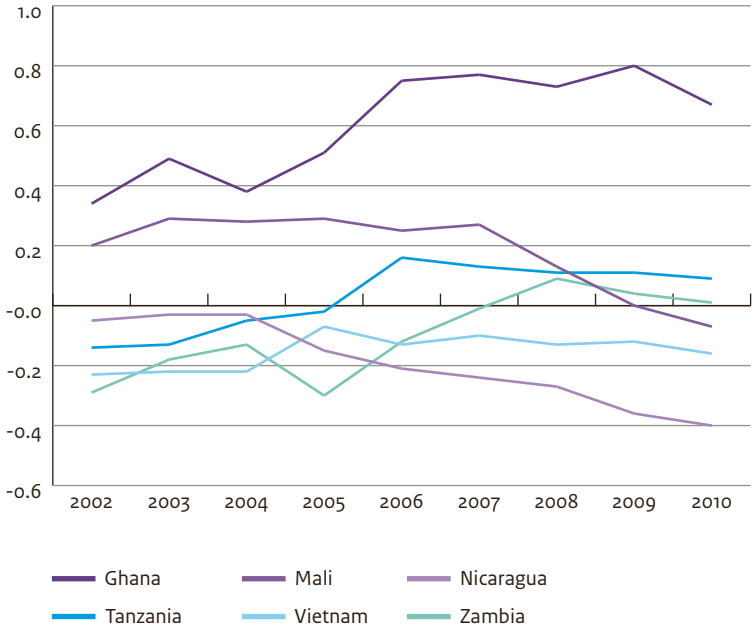
Table 5.7: Impact of policy dialogue

	Ghana	Mali	Tanzania	Zambia	Nicaragua	Vietnam
PFM	Yes	Yes	Yes, but stagnated later	Yes	Yes	Yes
Poverty expenditure or expenditure on social sectors	Yes	Yes	Yes	Yes	No	Some
Macro-economic stability	No, not a subject in dialogue	No, especially influence by IMF and UEMOA	No, govern-ment did this itself	No, govern-ment did this itself	No, govern-ment did this itself	No, govern-ment did this itself
Good governance (less corruption)	Very limited	Very limited	Very limited	Very limited	Very limited	Very limited
Business climate	Yes	Yes	No	No	No	Somewhat

Source: Our own assessment based on the country case studies. 'Yes' means that the country case studies conclude that donors had influence. The underlying studies (for our country case studies) established this based on 1) an observable difference between donor and recipient preferences, and an outcome that has shifted towards the donors' preferences, and 2) confirmation of this influence in interviews with key figures (not only with donors but also with government officials and representatives from civil society).

To what extent budget support was linked to better or worse governance can be determined in a somewhat more objective way by looking at developments in the Kaufmann indicators. It is striking that Ghana, which had the highest total score in 2003, improved even further (figure 5.2). Tanzania, Zambia and Vietnam also showed improvements (the latter marginally so). The most important improvement in Zambia took place under President Levy Mwanawasa after the agreement on budget support was completed in 2005. Governance worsened in Mali after 2007. That was the case in Nicaragua during the entire period of general budget support. Budget support never had the scope there, though, that it had in countries such as Tanzania, Ghana and Mali.

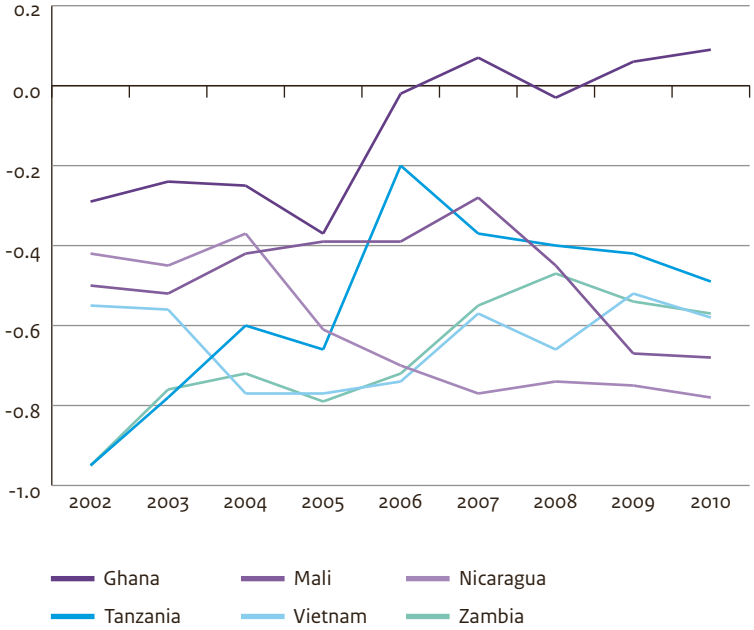
Figure 5.2: *Developments in the Kaufmann factor scores for good governance from 2002 to 2010 for the six countries*



Source: World Bank (Kaufmann indicators); elaborated on by IOB

Figure 5.3 shows development in the corruption indicator, in reply to those who suggest that budget support leads to more corruption (Moyo 2009, Boekestijn 2009). Between 2002 and 2010, the scores on the Kaufmann indicator for corruption improved in Ghana, Vietnam (after 2006), Zambia (until 2008) and Tanzania (until 2006). Corruption seems to only have increased over the entire period in Nicaragua and Mali, and in Mali this is due to a recent relapse. In Nicaragua, the volume of general budget support was limited. Based on these countries, then, one cannot conclude that budget support leads to more corruption.

Figure 5.3: *Developments in the Kaufmann indicator for control of corruption between 2002 and 2010 for the six countries*



Source: World Bank (Kaufmann indicators); elaborated on by IOB

The correlation between budget support and changes in the Kaufmann score across a larger spectrum of countries produces a brighter picture. We examined the relationship between the amount of budget support received between 2002 and 2010, and the change in the Kaufmann scores between 2000 and 2010. All correlation coefficients are positive and, with the exception of regulatory quality, significant (table 5.8). It is striking that there is a significant positive relationship between budget support (measured in both ways) and the change in the Kaufmann scores (as measured by the factor score), whereas this relationship was not found for the 2000 scores.

Table 5.8: Correlation between budget support and changes in Kaufmann scores (2000–2010)[1]

	% of GDP		% of ODA	
Democracy	0.30	*	0.24	*
Political stability	0.32	**	0.20	
Government effectiveness	0.26	*	0.23	
Regulatory quality	0.17		0.16	
Rule of law	0.40	**	0.36	**
Control of corruption	0.31	*	0.38	**
Factor score for good governance	0.42	*	0.37	**

1 *Change was measured by deducting the score in 2000 from the score in 2010. Budget support: average size between 2002 and 2010 as % of GDP and as % of ODA. Measured for 71 low-income and lower middle-income countries.*

* *Significant at 5% level; ** significant at 1% level.*

The positive relation between budget support and developments in governance does not necessarily point to a causal relation: progress in good governance may also have influenced the decision to continue providing budget support. In order to check this, we examined the correlations between budget support (as % of GDP) and the factor score for good governance every year, while we also examine the correlation with values from previous years. The second column in table 5.9 shows the correlation coefficients of budget support (in the same year t and in previous years) with the factor score for good governance in year t, and the third column shows the correlation coefficient of factor scores in the same year t and previous years with GBS in year t. All correlation coefficients are positive, but they are higher for budget support in previous years than for the factor scores in previous years. The relationship seems to get stronger the further back one goes with budget support, while it keeps getting weaker as one looks at the scores for good governance further in the past. The correlations between good governance in the years t-2, t-3 and t-4 and budget support in year t are not significant. This seems to suggest that budget support had more of an impact on the quality of governance than vice versa.

In theory, it could also be that other factors had an impact on both budget support and good governance, for example economic growth or reaching the HIPC initiative's Decision Point at an early stage. The financial stability that HIPC has introduced could also have had a positive effect on the quality of governance. A closer analysis, however, shows that neither economic growth, nor reaching the HIPC Decision Point at an early stage can explain this: countries that reached the Decision Point early did not make greater improvements on the Kaufmann indicators than other countries. On the other hand, budget support does have a positive correlation with changes on the Kaufmann indicators, even after controlling for HIPC.

Table 5.9: Correlation between GBS as % of GDP and good governance[1]					
GBS as % GDP	Good governance (factor score) in year t		Good governance (factor score) in:	GBS as % GDP in year t	
Year t	0.15	*	Year t	0.16	*
Year t-1	0.16	*	Year t-1	0.13	*
Year t-2	0.17	*	Year t-2	0.10	
Year t-3	0.17	*	Year t-3	0.09	
Year t-4	0.18	*	Year t-4	0.05	
Year t-5	0.17	*			

[1] *Measured as factor score of the Kaufmann indicators.*

* *Significant at 5% level.*

5.6 Conclusion

The academic literature has examined the impact of aid in general on political good governance and also on other elements of good governance. The findings are somewhat ambiguous. This is not surprising, because the category 'aid' is extremely heterogeneous in nature and in motives. Looked at over a long period of time, much aid was provided in the framework of the Cold War in order to keep friendly undemocratic regimes up and running. Empirical, quantitative research on the relationship between budget support and good governance has not been conducted yet. Budget support could have a positive effect through the policy dialogue and because it essentially promotes government transparency democratic accountability.

In theory, donors can influence good governance through selection conditions that are attached to budget support in advance. But this barely happened in practice, if at all. We conducted a cross-section analysis and showed, for example, that countries with substantial budget support did not get better scores on the Kaufmann indicators for good governance than other low and lower middle-income countries. This is confirmed by an analysis of the case studies. Some of the 'underlying principles' had not been met at all when budget support started, especially in the area of good governance. The willingness to work on improving a government's financial management, however, was often a necessary ingredient, and that was always present. It seems that in the early 2000s, joint systems of budget support were especially launched in countries that had been admitted to the HIPC initiative or that were already far ahead in that process. These countries already had a PRSP and a prudent macro-economic policy, but this also illustrates donors' path dependency.

In practice, donors have primarily attempted to exert influence on policy and governance by means of the annual agreements that accompany the delivery of budget support. In addition to the 'underlying principles' that must be respected, a matrix with performance indicators was developed every year. The performances in the framework entail, on the one hand, policy or measures (process indicators), and simultaneously outcomes. Basically, there is more ownership with outcome indicators because recipients can determine their own policies. But in practice, reliable annual figures are rarely available or the influence of the government on the outcomes is marginal. Donors were eager to control with the framework and had different opinions about controlling via outcomes (results) or via policy (processes). Therefore, both were done in practice. Donors also wanted to control in many areas, which resulted in extremely extensive frameworks. It was not always clear where the priority lay. Moreover, indicators were not always relevant, could not always be reliably measured every year, and could not always be influenced by the government.

Over time, donors started to take the underlying principles related to good governance more seriously, and they often suspended budget support because of corruption, human rights violations or elections that were not completely fair. Suspension of budget support rarely led to change as the donors would like to have seen it.

Process targets were sometimes implemented, but mainly when donors and recipients essentially agreed on what should happen. In other cases, changes were implemented either with delay or not at all, or they were purely cosmetically or formally implemented without anything substantial changing at all. This is usually true, for example, for good governance issues such as making the judiciary more independent, promoting the participation of civil society or making the public sector more meritocratic. Progress was also made in governments' financial management. But on this point too, commitment was already present, and ancillary technical assistance from donors also contributed to this.

The available evaluations and the six case studies show that donors only had limited influence on good governance with budget support. A cross-section analysis shows that there is a positive relationship between the amount of budget support received between 2002 and 2010, and an improvement on the Kaufmann indicators for good governance between 2000 and 2010. Furthermore, it appears that budget support was not a response to improved governance. These findings correspond somewhat to a recent study (Dutta et al. 2011), discussed in section 5.2, which identifies an 'amplification effect' of aid for the effect on democracy. If a positive trend already exists in terms of good governance, then budget support can reinforce it.

6

Budget support and economic growth

6.1 Introduction

Not many *international comparative* studies on budget support have been conducted yet. An important reason for this is that the instrument, as we know it today, is still fairly recent. International organisations, such as OECD/DAC, have only been classifying this modality in a separate category in their databases since the beginning of this millennium.

Another reason is the complexity of international comparative research on the relationship between development aid and economic growth. Increasing economic growth is not aid's only objective. It also aims to give recipient countries support *because* they are doing less well. Therefore, arguments that anticipate a positive correlation as well as a negative one appear to be valid. This makes it difficult to measure the impact of aid.

This chapter outlines the empirical evidence on the impact of budget support on economic growth. It starts with a brief summary of the literature on the relationship between development aid and economic growth (section 6.2). This literature has determined international comparative research on the impact of budget support. Section 6.3 subsequently analyses the relationship between budget support and economic growth. Section 6.4 maps out the results of individual case studies. Section 6.5 presents a number of conclusions.

6.2 Development aid and economic growth

The first studies on the relationship between aid and economic growth were still handicapped by a lack of data. Moreover, statistical and econometric techniques were also less advanced than they are today. The studies also had important methodological limitations, because they did not take into account the *endogeneity* of development cooperation mentioned above: the relationship between aid and economic growth is essentially negative, because development cooperation focuses on poor countries with major economic problems (Roodman 2008).[62] This effect will first have to be 'filtered out' before reliable measurements of the contribution of aid to economic growth can be made. Economists were continuously searching for increasingly sophisticated techniques to solve methodological challenges, but fundamentally tackling the Achilles heel remained difficult. Ignoring this endogeneity problem contributed to the famous *micro-macro paradox* (Mosley 1987). While many evaluations of individual projects pointed to the positive impact of development aid, this impact was barely discernible at the macro-economic level.

From the mid-1990s onward, a huge flow of publications appeared that did take the endogeneity of aid into account. One of the first and most influential of these was a study published in 1997 by Craig Burnside and David Dollar.[63] The researchers concluded that aid only has a positive impact on economic growth in countries with good macro-economic

[62] See Annex V.

[63] The concept started circulating from 1997 onwards in academic circles, but the article was published in 2000.

policy. This conclusion was reiterated in the World Bank's influential report, *Assessing Aid*, published in 1998, which was co-authored by David Dollar. Other researchers produced similar findings (for example, Collier and Dehn 2001; Collier and Dollar 2002 and 2004; Collier and Hoeffler 2004). Collier and Dehn also studied the impact of negative price shocks, such as a sharp decline of export prices (particularly raw materials). The authors concluded that it is important that aid absorbs these shocks, and this is also in line with arguments in favour of balance of payments support (see also chapter 2). The conclusion also corresponded with the findings of Guillaumont and Chauvet (2001), who argued that aid had an impact in countries with major economic problems, caused by the exchange rate or a natural disaster, for example. In 2006, Goderis and Verbon published the findings of research on the impact of Dutch aid, in which they used the same econometric approach. The authors also concluded that Dutch bilateral aid only had an impact in countries with good policy. There was even a negative impact in countries with bad policy. A second striking finding was that multilateral aid had a negative impact, so the Netherlands was better off not parking its bilateral aid with international organisations.

The recommendation in the *Assessing Aid* report that aid should focus more on countries with good macro-economic and good overall policy had a major impact on the policy of the World Bank and bilateral donors, including the Netherlands (see also chapter 3 and Easterly 2003). The academic world was more critical of the report. Lensink and White (2000) showed that the findings were not particularly solid and that minor changes to the model could lead to completely different results. Easterly, Levine and Roodman (2004) repeated Burnside and Dollar's regressions, but added new data, after which the previously measured impact had disappeared. Hansen and Tarp (2001) presented a more general criticism of 'aid and growth regressions'. According to these researchers, there was insufficient focus on the theoretical foundation and the econometric technique for assessing the impact, which meant that outcomes were too sensitive to the specification of the model and/or choice of methodology. They came to the opposite conclusion, namely that there is no empirical evidence supporting the contention that aid only works if the recipient country has good macro-economic policy. Dalgaard, Hansen and Tarp (2004) established that the interaction effect of aid and good macro-economic policy is not significant if the lower effectiveness of aid in the tropics is taken into account.[64] In the same year, Burnside and Dollar (2004) showed that their conclusions held with new data as well, but they did had to adapt the specifications of their model for that, whereby the focus shifted from good macro-economic policy to the importance of (economic) institutions. This conclusion is also important for budget support: the modality assumes, on the one hand, that these institutions are functioning well, while donors, on the other hand, assume that they can enforce their improvement using budget support as a carrot (see chapter 2). The results of this review show that empirical evidence is lacking for both: donors have not, de facto,

[64] The question remains, of course, why aid is less effective in the tropics. According to the authors, climatological circumstances are less favourable for humans (more diseases) and agriculture (less fertile soil and drought). These arguments are strongly affiliated with the work of Sachs and Warner (1997). Because a large number of African countries had poor macro-economic policy during the period that this research took place, there is a high correlation between climate (tropics) and macro-economic policy, which is one reason why the researchers were able to find both impacts.

let themselves be led by the quality of the institutions, nor have they had great influence on this with budget support (see also chapter 5).

Table 6.1: The relationship between aid and economic growth*

Year	Author(s)	Period of analysis	Significant impact	Conditions / circumstances
2000	Burnside and Dollar	1970–1993	Yes	Good macro-economic policy
2001	Guillaumont and Chauvet	1970–1993	Yes	Highly effective in difficult economic circumstances (e.g. disasters and badly deteriorating exchange rate)
2001	Collier and Dehn	1974–1993	Yes	Sound macro-economic policy; highly effective with negative price shocks
2001	Hansen and Tarp	1978–1993	Yes	Diminishing returns
2002	Collier and Dollar	1974–1997	Yes	Sound macro-economic policy
2004	Collier and Hoeffler	1974–1997	Yes	Especially effective in countries recuperating from civil war with good macro-economic policy
2004	Dalgaard, Hansen and Tarp	1974–1997	Yes	Aid is less effective in tropical areas
2004	Burnside and Dollar	1990–1999	Yes	Good (socio-economic) institutions
2005	Rajan and Subramanian	1960–2000	No	n.a.
2006	Djankov et al.	1960–1999	No	Negative impact on democracy and economic growth
2006	Goderis and Verbon	1970–1997	Yes	Aid is only effective in countries with good policy. Bilateral aid is effective, multilateral not.
2009	Angeles and Neanidis	1958–2001	Yes	Not too heavily colonised.
2010	Lessmann and Markwardt	1966–1997	No	Negative interaction effect of aid on decentralisation
2010	Arndt, Jones and Tarp	1970–2000	Yes	Aid is effective in the long term
2012	Kimura, Mori and Sawada	1973–2002	Negative	Negative impact of donor proliferation

* *Results of the country comparative research (cross-country regressions)*

Most studies found that aid no longer had an impact on incomes from the middle of that decade onwards. Rajan and Subramanian (2005) distinguished between channels (bilateral and multilateral aid) and objectives (social and economic aid), but in none of the cases did aid significantly contribute to economic growth. According to the IMF researchers, the methodological problems are too great to be able to reliably measure impact by means of cross-country regressions. Djankov et al. (2006) argued that aid has a negative impact on both a country's democratic processes and economic growth. The cause for this would be

'rent-seeking' behaviour of governments in recipient countries, as would apparently be the case with raw materials as well. Instead of pursuing productive activities themselves, governments would opt for easy profit, for example by granting oil concessions or by simply receiving development aid. Rent-seeking also diminishes democratic control. Some also argued that development aid plays into the hands of corruption (Djankov et al. 2006).

Lessmann and Markwardt (2010) found that aid did not have a significant impact on economic growth, but it did have a negative interaction effect: fiscal decentralisation has a negative impact on the aid – economic growth relation and political decentralisation had no impact. The researchers found that decentralisation only had a positive impact on the effectiveness of technical assistance. This conclusion has consequences for budget support, because donors often press for further decentralisation in the policy dialogue. The classic argument for fiscal and political decentralisation is that it makes allocation more efficient and government expenditure more effective, because lower-level governments are closer to their citizens and more well-informed about local needs for public goods. The economic literature, however, plays a different tune. The risk of corruption is greater with decentralisation precisely because local politicians and civil servants are close to the demands of interest groups (Prud'homme 1995; Bardhan 2002). A subsequent argument is that it is difficult in many developing countries to find qualified employees. Most qualified employees frequently move to the cities to work for central governments (Brueckner 2000). These factors mean that decentralisation can also have negative impacts, as Lessmann and Markwardt have shown. The researchers concentrated primarily on project aid, but – given the policy dialogue – there is no reason why the argument would not be equally valid for budget support. Moyo (2009) also suggested that development aid, and budget support in particular, encourages corruption and has a negative impact on economic development. This conclusion, however, is not based on her own empirical, country comparative research but on the available literature. Her most poignant argument is an intuitive one, namely that countries should have been much wealthier by now if aid had been used effectively. Dalgaard and Erickson (2009) and Dalgaard and Hansen (2010), on the other hand, showed that the assumed potential impact of aid is often overestimated. The authors calculated that if all aid in the past 30 years had been used effectively to increase investment, this still would only have led to a per capita increase in income over these 30 years of 6%-10%.

It also makes sense to compare the different results of the econometric research to see whether this leads to more definitive conclusions. Roodman (2007) analysed the robustness of the results of the seven (in an academic sense) most influential studies (from a total of more than 100). He subjected them to a number of tests, including a change of the model specification, the inclusion of new data and the removal of a number of outliers (strongly deviating figures). Based on this, he concluded that the results are not robust. Doucouliagos and Paldam (2008) used the results of 68 articles, from a total of more

than 100 publications, for a *meta-analysis*.[65] Based on this, they concluded that there is no econometric evidence that aid has a positive impact on economic growth. Some years later, they repeated the analysis with new data, but reached the same conclusion (Doucouliagos and Paldam 2011). Mekasha and Tarp (2011) repeated the authors' first analysis, and yet they did find a positive and statistically significant result. They pointed out several questionable choices in Doucouliagos and Paldam's approach.[66]

Other recent research also yields positive results. Angeles and Neandis (2009) hypothesised that much aid is ineffective because the ruling elite do not use the resources to reinforce economic growth. This behaviour could be prompted by the example of European colonists who showed little interest in the economic growth of the areas under their submission. This hypothesis is strongly reminiscent of the conclusions arrived at by Acemoglu, Johnson and Robinson (2001 and 2002; see also Easterly and Levine, 2003 and Acemogu and Robinson 2012). According to Acemoglu et al., European immigrants established two kinds of colonies: in regions with less hostile climates, such as the United States and Canada, they founded institutions based on the European model. In areas rich in raw materials with a hostile climate, they mainly introduced institutions aimed at extracting and exporting these resources. In both cases, these institutions continued to exist after independence. One of the explanations why new elites took over the behaviour of the colonists is the existence of different ethnic groups. The patronage system pays particular attention to one's own ethnic group. Angeles and Neandis found that aid had a significant positive impact on economic growth, while the interaction term of aid and the degree of colonisation was negative. This conclusion has consequences for budget support. It suggests that the instrument will not be effective in countries that were heavily colonised.

Arndt, Jones and Tarp (2010) examined in detail the above-mentioned methodological problems and devoted a great deal of attention to their solution. Extensive testing led them to conclude that aid has a significant positive impact on economic growth mainly in the *long term*: increasing aid by 10% of the recipient country's GDP results in the economic growth per capita of the population in the long term of more than one percentage point.

We may conclude that there is sufficient empirical evidence for the positive long-term impact of aid on economic growth. The above-mentioned study is state of the art and was more rigorously conducted than many other studies. It remains difficult to show a positive relationship for the short term, precisely because the correlation between aid and economic growth in the short term is negative (Roodman 2008): countries receive aid *because* they are doing poorly economically. Another reason why it is difficult to show an immediate positive

[65] The technique basically comes down to the following: different studies produce different results, which are often partly determined by differences in how the sample survey is composed. Combining results from different studies expands the sample survey, which makes it possible to produce more accurate and more robust estimates of the impact. In the case mentioned, the use of the technique is actually incorrect, because the different studies essentially use the same data (and therefore the same sample survey).

[66] Doucouliagos and Paldam responded to this in 2012 with a new article, which they claim shows that their conclusions were in fact correct.

impact is that a large share of aid is not aimed at promoting short-term economic growth at all.

6.3 Budget support and economic growth

6.3.1 Budget support vs. other modalities

Initial research on the impact of *programme aid* stemmed primarily from dissatisfaction with existing estimates of the impact of development aid on economic growth. The different studies estimated the short-term impact of all development aid on economic growth, without taking into account the different forms of aid or their goals. This assumption, that all aid has the same objective or short-term impact, is questionable. The main purpose of emergency relief, for example, is to tackle the direct consequences of catastrophes. This form of aid in particular had been negatively correlated in the short term with economic growth, precisely because of the negative impact a disaster has on economic activity. Other forms of development cooperation aim at improving a country's health care or education system, for example. These activities are expected to contribute to economic growth, but only in the long term.

Clemens, Radelet and Bhavnani (2004) were among the first to attempt to isolate the different objectives of aid from each other. The authors distinguished between emergency relief, aid focused on the long term (such as education) and aid aimed at short-term economic growth. The latter category included balance of payments support, investments in infrastructure and aid for the production sectors (such as agriculture and industry). This classification enabled them to find strong and significant impacts of aid in the short term (approximately 53% of total aid), including, according to the three researchers' definition, budget support. By distinguishing between different forms of aid, they found that the impact was two to three times greater than previous estimates. According to the authors, one dollar of aid, including budget support, yields an economic return of 1.64 dollars. The impacts did not appear to depend on good economic policy, but they were apparently greater in countries with stronger (economic) institutions and countries with higher life expectancy. The authors discovered a major impact in sub-Saharan Africa: if the short-term aid to Africa had not been 5.3% of GDP but the global average of 2.7%, then the *average* economic growth on the continent would have been almost 0.6% lower. The researchers also reached a positive conclusion about the impact of debt relief: debt payments have a negative impact on economic growth.

Table 6.2: Budget support and economic growth

Year	Author(s)	Object	Period of analysis	Impact	Sign.	Conditions
2003	Cordella / Dell'Ariccia	Budget support	1974-1977–1990-1993	Budget support more effective than project aid	Yes	Alignment of objectives; limited in size
2004	Clemens, Radelet and Bhavnani	Programme aid, emergency relief and aid aimed at the longer term	1973-2001	Aid aimed at short term is effective; aid for the longer term is not effective	Yes	Aid for the short term, maximum of 8%-9% of GDP
2007	Mavrotas and Ouattara	Programme aid and project aid	1970-2001	Project aid leads to higher capital expenditures, programme aid to higher government consumption	Yes	n.a.
2008	Ouattara and Strobl	Financial programme aid	1974-2001	Positive impact of project aid; negative impact of financial programme aid	No	Project is not effective in tropics; diminishing returns
2009	Annen and Kosempel	Technical assistance	1970-2004	Technical assistance has a positive impact; other aid does not	Yes	Technical assistance is not effective in countries where aid is fragmented
2011	Bigsten, Platteau and Tengstam	General budget support	2000 -2009	Positive impact of budget support	Yes	Greatest impact is only achieved after several years

Cordella and Dell'Ariccia (2003) distinguished between project aid and programme aid. They alluded to the latter, not entirely accurately, as budget support. The authors concluded that the effectiveness of aid depends on the recipient's social preferences and own resources: project aid is more effective if donor and recipient preferences differ and if the recipient's own resources are relatively limited. Budget support, on the other hand, is more effective if donor and recipient preferences are aligned and if assistance is small relative to the own resources of the recipient country. In line with earlier studies by Craig Burnside and David Dollar (2000), for example, these authors only discovered a significant positive impact of budget support in combination with good economic policy. These conclusions were based on theoretical considerations as well as on empirical research. The theoretical argument is that if recipients have few resources, then they will not have much leeway in their budget, and therefore fungibility problems of project aid will be limited. If donor and recipient preferences are not aligned, then the donor will have a better chance of achieving its objects via projects – without considerable fungibility risks. But if preferences are aligned,

then there is no reason not to let recipients run their own programme, while fungibility undermines the effectiveness of projects when recipients do have leeway.

The researchers used data in their analysis for 45 countries for the period 1973–1993, split over five periods of four years (therefore resulting in 225 observations). Programme aid consisted primarily of balance of payments support, import support and debt relief during this period.[67] The motives of programme aid were therefore primarily economic and short term. It was therefore obvious that the authors would find that 'budget support' had a greater impact.

Unlike the other studies, Cordella and Dell'Ariccia (2003) were more or less forced to use commitments instead of actual disbursements. According to Ouattara and Strobl (2008), the researchers' estimates are not reliable, because commitments often deviate considerably from actual disbursements (and are often even higher).[68]

Ouattara and Strobl (2008) distinguished in their own research between four aid modalities: project aid, financial programme aid, technical assistance and food aid. They discovered a positive correlation between project aid and economic growth, but a negative impact of programme aid on economic growth. This finding is striking because it is at odds with the results of both Clemens et al. (2004) and Cordella and Dell'Ariccia. Ouattara and Strobl did not find evidence to support Burnside and Dollar's contention that aid effectiveness depends on the quality of the macro-economic policy.[69]

Ouattara and Strobl also concluded that too much technical assistance can have a negative impact on the recipient country's economy.[70] This conclusion is at odds with findings by *Annen and Kosempel* (2009), according to whom technical assistance is more effective than other forms of aid, providing that aid to the recipient country is not fragmented. The researchers argue that technical assistance influences productivity and thus economic growth, while other aid is a transfer of income that buffers available resources for consumption and investment.

67 During these years, the OECD/DAC secretariat did not keep track of data for budget support as a separate category yet. The authors included the macro-support and programme aid that was part of the IMF and World Bank adjustment programmes in the budget support category.

68 This means that Cordella and Dell'Ariccia presumably underestimated the impact. After all, if the actual disbursements were lower than the committed amounts, the same impact would be achieved with an on average lower amount.

69 Following Dalgaard et al. (2004), the researchers also concluded that aid is ineffective in the tropics.

70 Ouattara and Strobl's findings deviate from those of other researchers. There are several explanations for this. First, these authors' findings are less robust than they claim (p. 360): the 'negative impact' of financial aid is not significant in many of the specifications. A second problem that presumably plays a role is that the inclusion of several forms of aid in a single model, which probably leads to multicollinearity problems (see below). This means that we cannot attach much value to the estimated coefficients (impact).

In 2011, Bigsten, Platteau and Tengstam conducted research, in the framework of a study on how to enhance EU aid effectiveness, on whether general budget support was a more effective form of aid than other modalities. The researchers concluded that budget support had a significant positive impact on economic growth. This impact increased over time: budget support had a bigger impact on economic growth after two years than after one. After three years, the impact had almost doubled: budget support in the amount of 1% of GDP contributes 0.6 percentage points *more* to the GDP growth per capita of the population than other forms of aid. This finding is consistent with the economic literature on aid effectiveness (see, in particular, Arndt et al. 2010), which argues that aid will have a bigger impact in the longer term. Bigsten et al. estimated that an increase in GBS as a percentage of total aid (for all countries) of 4% leads to a total additional growth in recipient countries of €1.8 billion.[71]

6.3.2 Recent data

As tables 6.1 and 6.2 show, a large part of the empirical research focuses on the years 1970–1995, years in which many, especially African, countries were not doing well economically (or often politically), partly because of bad economic policy and malfunctioning institutions. From the late 1990s onwards, a large number of countries, many of which were African, displayed much more favourable growth figures, however, while in the 1990s, partly under pressure from the IMF and the World Bank, the macro-economic policy had improved.

Radelet (2010) identified 17 'emerging' countries whose growth figures per capita of the population have risen from 2% to more than 5% per year. Given the high population growth in these countries, the average economic growth is approximately three percentage points higher. The author distinguished between emerging countries, threshold countries, oil exporters and other countries. The emerging countries are the non-oil-exporting countries that are doing economically well, such as Mozambique, Rwanda and Botswana. Oil-exporting countries include Angola, Sudan and Nigeria. The threshold countries did not achieve a 2% growth per capita of the population in the past ten years, although recent growth figures are optimistic. These countries include Kenya, Benin, Malawi and Senegal. The group of countries in which there is barely any economic growth includes Burundi, Congo, Eritrea, Somalia and Zimbabwe.

A comparison shows that emerging and threshold countries in particular have been on the receiving end of budget support, while this was not, or barely, the case with most of the other countries.

[71] Incidentally, the researchers did not check for potential endogeneity, which can lead to overestimation of the impact.

Table 6.3: Budget support and economic development in Africa

	GBS countries	Little/no GBS	Total
Emerging countries	11	7	18
Threshold countries	5	1	6
Oil-exporting countries	1	7	8
Other countries	7	9	16
Total	24	24	48

Source: Radelet (2010)

The successful countries that received little or no budget support include Botswana, Namibia, Ethiopia, Liberia, Sao Tomé and Principe, and the Seychelles. Kenya is a threshold country without much budget support. The less successful countries that did receive relatively much budget support include Burundi, the Central African Republic, the Comoros, Djibouti, Guinea-Bissau, Niger and Togo. Cameroon is an oil-exporting country with budget support.

6.3.3 Diminishing returns

Hansen and Tarp (2001) were among the first to use an international comparative approach to study the possibility of diminishing returns in development aid. They concluded that as aid increased, the impact on economic growth diminished. Clemens et al. (2004) also concluded that there are limits to the scope of aid: countries would reach the maximum growth impact when the short-term aid amounted to 8%-9% of GDP. Cordella and Dell'Ariccia's (2003) conclusion that budget support is only effective if aid is relatively limited vis-à-vis the recipient country's own resources emerged from the same approach.[72] Ouattara and Strobl (2008, p. 360) found these effects for project aid.

Most researchers (see, for example, Clemens et al. 2004) explain diminishing returns as a result of limited absorption capacity. This was not a plausible conclusion, according to Ouattara and Strobl (2008), because almost all countries have a level of aid below the critical threshold. They assumed that this was the result of increasing coordination costs, both for donors and recipient countries. This conclusion is an implicit plea for budget support, because the high coordination costs of project aid are a major argument in favour of providing budget support. This element is also discussed in research by Kimura et al. (2012), who show that a proliferation of donors has a negative impact on a recipient country's economic growth (for a comparable result, see also Bigsten et al. 2011). The argument in favour of this is that the lack of coordination weakens ownership, thereby leading to inefficiencies in aid absorption (p. 7).

[72] Economists analyse diminishing returns by including a quadratic term (aid × aid) in the equation. A negative coefficient then points to diminishing returns. If aid increases, then the impact will be negative above a certain level. Later research shows that the inclusion of such a term can be problematic from a statistical point of view (see also Roodman 2008).

6.3.4 Dutch disease

If general budget support constitutes a large part of the budget and the government uses the resources to buy non-tradable goods and services, then this can lead to an appreciation of the currency and/or increase inflation and diminish the competitiveness. Younger (1992) was among the first to discuss the possibility of this problem, known as the 'Dutch disease' effects. It concerns two effects, which have the same consequences for the export sector's competitiveness:

a Through its income effects, aid also effectively raises demand. This subsequently results in the price increases of domestic goods and labour. The higher costs make the sectors that focus on export (or which have to compete in the international trade) less competitive;

b The greater availability of foreign currency can contribute to a rising exchange rate, which also diminishes competitiveness.

The result of both factors is that part of the potential increase of income is lost as a result of declining export, unless the aid is mainly used to improve productivity in sectors that compete on the global market. Since budget support resources are mainly used for investment in social sectors (see also Mavrotas and Ouattara 2007), there is a relatively high risk that the Dutch disease will take effect. On the other hand, these effects are easily overestimated, because major (hidden) unemployment prevents an upward impact on salaries.

White and Dijkstra (2003) concluded in an extensive study on the impact of programme aid, that there was barely any question of Dutch disease effects. First of all, aid often resulted in a smaller price hike of non-tradable goods, because the aid helped to finance budget deficits. And second, conditionality ensured liberalisation and/or the devaluation of the currency.

Killick and Foster analysed the macro-economic impact of increased aid in the early 2000s in seven African countries. The exchange rate only appreciated somewhat in Ghana, and exports increased and inflation decreased in almost all countries (Killick and Foster 2007). This means there was no Dutch disease, but the authors were cautious: perhaps the exchange rate would have depreciated without an increase in aid. The Ugandan government implemented an active policy to prevent an increase of liquidity and appreciation of the exchange rate by selling government bonds in response to aid (Atingi-Eto 2006). The disadvantage of this, however, is that government debt increases and less credit is available for the private sector (Brownbridge and Tumusiime-Mutebile 2007). Still, many authors are convinced that aid increases the range of available goods and that the impact of the Dutch disease is therefore marginal (Adam and Bevan 2006, Serieux 2007).

Rajan and Subramanian (2006) assumed that if foreign aid really went hand in hand with Dutch disease effects, then this would mean that growth in labour-intensive sectors in developing countries (where they have a comparative advantage) will lag behind in terms of growth in other sectors. This also means that the difference in growth rates in countries

that receive a lot of aid is greater than in countries that received little or no aid. Indeed, this hypothesis was supported by empirical research. Clausen and Schürenberg (2009) anticipated substantial economic leakage in Zambia, in particular because the export of copper stood to suffer considerably from price adjustments. Elbers and Gunning (2011), on the other hand, concluded that the presumed mobility of labour and capital in the copper mining industry is hardly realistic. They showed that if the assumption of complete factor mobility between the mining sector and non-mining sectors was relaxed, the predicted Dutch disease effects would be much lower. Other studies show that the Dutch disease effects did occur in the first decade of this millennium in Zambia, but then especially because *more* copper was exported (De Kemp, Faust and Leiderer 2011). In 2005, the kwacha appreciated as a result of both the high price of copper (and export) and the impact of debt relief. According to Devarajan et al. (2008), foreign aid can have an especially negative impact when it is volatile and generally instable. The authors conclude that '… unfavorable macroeconomic dynamics of scaled-up aid are the result of donor behavior rather than the functioning of recipient economies' (p. 256). One of the objectives of budget support is to make aid more predictable, which would diminish the effects of the Dutch disease. Aiyar and Ruthbah (2008) came to the conclusion that more aid has not generally led to an appreciation of the exchange rate (see also Devarajan et al. 2008). The countries that were studied largely used the additional aid to build up international reserves.

6.4 Results of case studies

6.4.1 Evaluations

The extensive research carried out by White and Dijkstra (2003) for the Swedish International Development Cooperation Agency was one of the first major studies on the impact of programme aid. The evaluation covered nine country case studies, six of which were in Africa. The researchers analysed the impact of programme aid on macro-economic variables, such as imports and government expenditure, in order to draw conclusions about the impact on economic growth. They combined a qualitative case study approach with quantitative analyses, including the use of simulation models. For the period being researched, the focus was on macro-support, particularly balance of payments support, debt relief and import support, and less so on general budget support.[73] In other words, the contribution to macro-economic stabilisation (both internal and external) was the main concern (see also p. 527).

The conclusions in the book (pp. 538–539) combine theoretical considerations with the findings from the nine case studies, as well as other insights from the empirical literature: Aid has helped to increase imports by 20% to 50% in the nine countries. This increase had a positive effect on consumption and investment, and a negative effect on inflation;

- Aid did not lead to a proportionate increase in government expenditure, which also had a negative effect on inflation (by limiting the budget deficit);

[73] This also means that the conclusions are valid for the 1990s.

- Aid supported the local currency, which softened the effect of the liberalisation of the exchange rate. This also had a deflationary effect;
- Private investment responses to aid were weak; and
- Aid did not have a major impact on government expenditure in the social sectors in most countries.
- The authors' overall conclusion is that there can be no doubt that by increasing imports and expenditure, aid contributed to higher prosperity, but that the effect was neither strong, nor sustained.

The *Joint Evaluation of General Budget Support* (2006) paid special attention to the 'front side' of the process, the direct influence that the donors' budget support had on government policy, and less attention on the influence of that same government policy on the objectives of budget support.[74] An initial conclusion from the synthesis report is that budget support has helped maintain the macro-economic stability that most countries had previously achieved. The government policy of the recipient country did play an active role in this, particularly in absorbing the impact of the aid's fluctuations and unpredictability. Various countries (such as Rwanda and Mozambique) had to borrow from domestic markets to make good on deficits, while Uganda could live off the reserves it had built up to prevent the exchange rate from increasing. In the case of Malawi, the report concluded that the situation only got worse in the short term after budget support was withdrawn because the country did not comply sufficiently with the budgeting rules (p. 66). The evaluation did not find that budget support had a negative impact on tax revenue. The instrument did help to finance the abolition of user contributions (in education and health care).

In 2010, IEG, the World Bank's evaluation department, published an evaluation of the *Poverty Reduction Support Credits* (PRSCs), the World Bank's most important instrument for budget support. In total, 27 countries received budget support through this instrument. IEG examined in detail the support given to seven countries. An important conclusion made in the report is that 22 PRSC countries had higher economic growth, achieved higher growth rates and also scored better in other indicators (such as inflation and export) than comparable countries.[75] The economic growth was particularly higher in industry and services.

[74] The evaluation included seven country case studies: Burkina Faso, Malawi, Mozambique, Nicaragua, Rwanda, Uganda and Vietnam.

[75] Five countries were excluded from the analysis because they only started to receive PRSC after 2005. IEG did not examine whether the differences were significant.

Table 6.4: PRSC Countries and economic growth

	No. of countries	Average growth 1995–1999	Average growth 2000–2007	Difference
PRSC countries	22	0.8%	4.2%	3.4%
Non-PRSC countries with a CPIA score of 3 or higher (2007)	37	0.5%	3.3%	2.8%
Non-PRSC countries	52	-0.1%	2.5%	2.6%
Total IDA countries	74	0.2%	3.0%	2.8%

Source: IEG (2010); Vol. 2, p. 41.

Although IEG tried to correct for selection effects, the organisation was aware of potential a remaining selection bias: 'PRSCs had better macroeconomic results than others – both in the PRSC period and before' (IEG 2010, p. 71). Countries gained access to this form of aid *because* they were already doing better. The governments in some of these successful countries, such as Vietnam, had already instigated important reforms, so that these could not be attributed to the PRSCs. Nonetheless, the table suggests an annual net impact of 0.6% growth per capita of the population, and that is an impressive result.

IEG did criticise the lack of a concrete growth strategy in many cases. Most countries, both PRSC and non-PRSC countries, had a comparable macro-economic policy, so that this could hardly explain the differences in growth figures. In many PRSC countries, such as Benin, Ghana, Laos and Mozambique, donor activities were especially aimed at improving the investment climate.

Mozambique is a good example of how budget support can contribute to economic growth, according to IEG. There, aid was geared towards maintaining macro-economic stability, PFM, financial sector issues, the investment climate and improving agricultural productivity. It seems that the ownership of the Mozambican government was an important factor in achieving these successes. Budget support was less successful in other countries. In Benin, economic growth was relatively low compared to other countries in the region, partly because the country did not succeed in implementing reforms in the cotton or energy sectors.

Country case studies generally do not try to estimate the impact of budget support on economic growth. An exception is the evaluation of the budget support given to Tunisia (Caputo et al. 2011). According to this evaluation, budget support given to the country (by the European Union) had a positive impact on economic growth because it contributed to macro-economic stability and a better investment climate.[76]

[76] The conclusions, however, are based on a very small sample survey of five countries in the region (over a period of twelve years).

6.4.2 The six country case studies

According to the consultants of the *Mali* evaluation (Lawson et al. 2011), the modality has significantly contributed to the economic growth of more than 5% a year. This figure was the highest among countries in the Economic Community of West African States (UEMOA). Various UEMOA countries with budget support (Burkina Faso, Mali and Benin) during the period 1990–2010 did indeed enjoy the highest growth figures in the region (see Mali case study). That was already the case around 2000, however. After that year, countries in the region without much budget support also had high growth rates (Senegal, for example). In Mali, budget support did make it possible to invest in priority areas, while maintaining macro-economic stability. The country barely had a deficit, which contributed to low inflation. Public investment compensated for stagnating private investment. It was mainly the *financial support*, however, that contributed to this result. The policy dialogue and conditionalities barely played a role in macro-economic policy. Government commitment, supported by the IMF and the UEMOA's convergence criteria, was much more important. An important factor in the economic growth, however, was the high price of gold. The relatively favourable economic development of Mali was overshadowed by high population growth, which limited the growth per capita of the population.

Other evaluations (including Zambia, Tanzania, Ghana, Nicaragua and Vietnam) are more cautious about their conclusions. Just as in the Mali evaluation, they conclude that the policy dialogue did not have a significant effect on macro-economic policy. Other factors, including debt relief, but in particular economic growth and government policy, were much more important. Indeed, budget support made it possible to increase government expenditure, especially in the social sectors, while maintaining macro-economic stability. This increase of government expenditure did subsequently have a spending effect, thereby contributing to economic growth (for Tanzania, see Mkenda et al. 2010).

The evaluation of *Ghana* (Lawson et al. 2008) concluded that budget support contributed to reducing the budget deficit, reducing domestic debt and increasing government expenditure. Given the size of the budget support, this was a modest contribution, however, with diminishing significance. According to the IEG evaluation of budget support given to Ghana by the World Bank, the joint policy dialogue played an important part in improving the investment climate, while the World Bank was effective in ending energy subsidies.

The relatively low economic growth in *Nicaragua* was attributable to the low price of the most important export product (coffee), according to the IEG (2010). Budget support did not have an important impact on economic growth. Dijkstra and Grigsby (2010) concluded that the unpredictability of budget support in Nicaragua and the late disbursements led the government to use it primarily to reduce the budget deficit and relieve domestic debt, which, however was important for maintaining macro-economic stability. Budget support did not lead to higher public expenditure, according to the authors.

Budget support made it easier for the government of *Zambia* to maintain macro-economic stability during the financial crisis without having to make drastic cutbacks. The engine of economic growth was the export of copper, bolstered both by the privatisation of the copper mines and the rise of the price of copper. Budget support (and debt relief in 2006) helped to maintain budgetary discipline, especially during the international economic crisis.

Vietnam enjoyed substantial economic growth between 2001 and 2006, which was attributable to the results in the five sectors that were the focus of World Bank support, according to IEG. These sectors were trade, development of the private sector, infrastructure, privatisation of state enterprises and reforms in the banking sector (IEG 2010, p. 74). These reforms had a high degree of ownership, and the Vietnamese government would have presumably enforced them without budget support as well (and had in fact already partially enforced them, see Vietnam case study on the CD-ROM). The financial support did make it easier to achieve the reforms, however.

6.5 Conclusions

While economic growth and poverty reduction are the central objectives of budget support, most evaluations pay surprising little attention to them. Positive impacts are more assumed than analysed in detail. There are several studies, however, that did examine the impact of budget support on economic growth with the aid of econometric international comparative research. The methodological challenges with this kind of research are considerable. This is not only because of the *heterogeneity* of aid (the many kinds and different objectives), but especially because of the intrinsic problem that aid is primarily meant to help the poorest countries move forward. As a result, the correlation between aid and economic growth is often negative. Recent research, which examines the methodological problems in detail and extensively tests the results, shows that aid generally does have a positive impact on economic growth, but especially in the long term.

Another complication when analysing budget support is that the instrument has several objectives, both short-term ones (such as contributing to macro-economic stability) and long-term ones. Budget support does not only attempt to contribute to a country's economic growth, it also has several other economic objectives, such as improving the health and living conditions of society's poorest people (cf. also the MDGs). Research shows that recipient countries mainly use the resources to invest in social services (including expenditures on education and health care). This means that the direct impact on economic growth in the short term will be limited. Interventions in the area of education and health care have a positive impact on economic development, but it can take a long time for these impacts to become visible.

Despite all methodological limitations, most studies show a limited positive correlation between budget support and economic growth. A recent World Bank evaluation also points out that countries which received *Poverty Reduction Support Credits* had higher economic growth than comparable countries that did not receive it. The assumption that budget support has a mainly negative impact on economic development is not supported by empirical evidence.

Another question is whether budget support helped improve economic policy, by way of the policy dialogue, and whether this in turn encouraged economic growth, or whether budget support dovetailed well with good economic policy. Chapter 5 already showed that donors were not able to significantly influence macro-economic policy (and often this was not necessary). The fact remains that financial resources had a positive impact on policy and economic development.

7

Budget support and poverty

7.1 Introduction

Poverty reduction is one of budget support's main objectives. The idea that the instrument contributes to this objective in an effective way is based on the following assumptions that constitute the rationale for the provision of budget support (see chapter 2):

- greater aid effectiveness;
- greater efficiency, which makes it possible to achieve more with the same resources;
- more aligned with recipient countries' poverty reduction strategies; and
- greater ownership.

The intervention logic has not been elaborated much, however, when it comes to improving the income position of the poorest groups. It does not explain in detail how budget support would lead to the reduction of poverty, other than through the support of national poverty reduction programmes. The latter usually free up resources to give the poorest groups better access to public services, particularly health care and education.

Evaluations also do not pay a great deal of attention to poverty reductions, but usually limit themselves to the effects on service delivery. Country comparative studies focus mainly on the impact on economic growth (see chapter 6), although a number of studies examine the impact of budget support on public services.

This chapter combines these sources in order to give a picture of the impact of budget support on poverty, including the income effects and the access to and use of public services, and the effects of these on social indicators. Section 7.2 discusses the relationship between absolute poverty in the strict sense: income (including production for personal use). Section 7.3 subsequently describes the empirical evidence on the relationship between budget support and social expenditures. The following section (7.4) outlines of the improvement of and access to social services. Section 7.5 examines to what degree the poorest groups have benefited from this. The chapter closes with several conclusions in section 7.6.

7.2 Poverty impact

7.2.1 Introduction

Although everyone has a picture of what the concept of poverty means, in practice it often leads to miscommunication and confusion. Many definitions, including that of the United Nations, use a multi-dimensional concept: poverty is in the first place a lack of prospects for providing oneself with the most immediate and basic needs. This expresses itself not only in terms of hunger and malnutrition, but also in terms of poor health, inadequate housing and a lack of safe drinking water. One of the characteristics of poverty is social exclusion, including education and political participation.

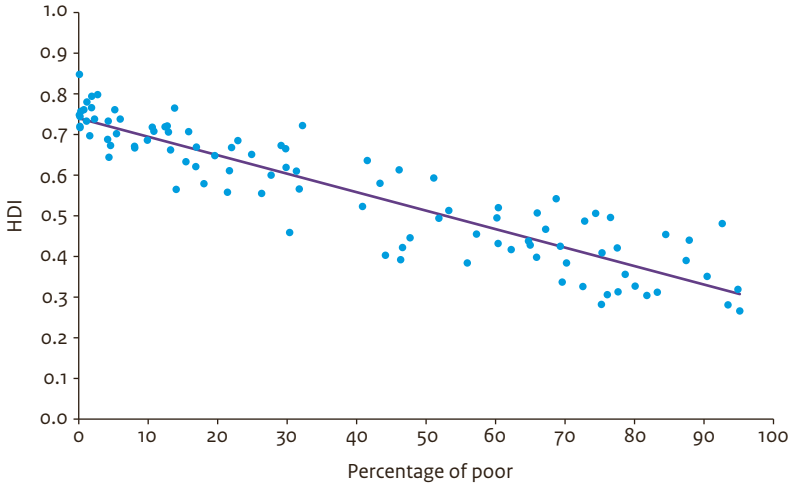
Poverty's multidimensional character makes it difficult to measure. Many poverty standards, such as the percentage of poor or the poverty gap, use income or consumption as the main indicators. Income standards have the advantage of being easy to present and compare. A thorough analysis of this concept of poverty is difficult, however, because income is not a good benchmark in many countries. That is why statistics agencies use other benchmarks, such as food shortage (based on a specific number of calories needed) or a broader 'basic needs' poverty line. One problem with this is that consumption patterns per region can vary and change over time. Non-monetary measures, such as the United Nations' Human Development Index (HDI), include other indicators as well, such as education and health. The UN index includes information about:

- average income (based on purchasing power parities);
- health, based on average life expectancy at birth; and
- education, based on literacy rates and enrolment ratios in primary, secondary and tertiary schools.

Even broader *deprivation indices* include factors such as housing, access to drinking water, sanitation and electricity as well.

In practice, the various indicators are strongly correlated: the poorest households have insufficient access to education and health care. Figure 7.1 shows the correlation between one of the World Bank's poverty indices (the percentage of people with an income of less than US$2 a day) and the UN Human Development Index.

Figure 7.1: *Relationship between percentage of poverty and Human Development Index (countries)*



Improved access to education and health care are important instruments for fighting poverty; on the one hand, it concerns directly combatting direct deprivation; on the other hand, these instruments, in addition to productive investments, contribute in the long term to creating better opportunities to increase income.

With budget support, donors aimed at achieving both objectives, even though they lacked a detailed intervention logic that indicated which objectives should be achieved and by when. This often resulted in disappointment, especially concerning the slow progress in reducing the percentage of households with an income below the poverty level.

7.2.2 Evaluations

The Joint Evaluation of General Budget Support (2006) actually did not make any pronouncements about the relationship between budget support and poverty reduction. The report only indicated that the teams from the country case studies were unable to determine the impact budget support had on poverty reduction. The evaluation mentioned the lack of reliable data, the fact that it was a recent phenomenon and methodological challenges as the most important causes. In fact, the case studies mainly described the impact on improvements in public services (see also section 7.3). The evaluation did warn against having too high expectations, however. Countries such as Mozambique, Uganda and Vietnam had considerably reduced poverty, which was mainly the consequence of reconstruction after civil and other wars that these countries were involved in. There was a good chance that the reduction of poverty would level out, because subsequent groups would be more difficult to reach. In this context, one could quickly draw the conclusion that budget support was ineffective.

Many evaluations of budget support restrict the analysis to the impact on poverty reduction policies. The question to what extent these policies have actually reduced poverty remains unanswered. The evaluation of the World Bank's Poverty Reduction Support Credits in Mozambique (IEG 2010b) is an example. The evaluation concluded that 'PRSC objectives with respect to setting the conditions for poverty reducing growth have been attained with moderate shortcomings' (p. 32). The report referred in particular to the high economic growth, but provided no information about a decline in poverty. Initially, the decline was strong, but it levelled off precisely in the first decade of this Millennium. Despite an economic growth of approximately 8% a year, poverty did not decline by more than one percentage point a year (Van den Boom 2011; Cunguara and Hanlon 2010). According to Van den Boom, this could be explained by Mozambique's dual economy, which focused too little on growth in small-scale agriculture but instead concentrated on subsidised labour-intensive growth in major industrial projects.[77]

The IEG synthesis report devoted more attention to the relationship between PRSCs and poverty. According to the IEG evaluation (2010), PRSC countries witnessed a relatively strong decline of poverty between 1999 and 2005 (of eight percentage points, as opposed to five percentage points in non-PRSC countries). The starting point in 1999 was essentially identical. A different development took place during the preceding period. Between 1990 and 1999, poverty declined in comparable countries more than in the future PRSC countries.

[77] IOB (2009) also warned of this in the context of a mining project in Mozambique.

Table 7.1: Poverty figures in PRSC and non-PRSC countries (1984–2005)

	1984	1990	1999	2005	Change 1999-2005
PRSC countries	52	49	43	35	-8
Comparable countries*	49	45	43	37	-6
Non-PRSC countries	45	51	44	39	-5

* *Non-PRSC countries with a CPIA score of at least 3.0 (37 countries). The non-PRSC group comprises 52 countries.*
Source: IEG 2010, p. 75.

7.2.3 Empirical analysis

If it is true that budget support has made a significant contribution to poverty reduction, then *in principle* one would expect countries that had received substantial budget support to have reduced poverty more than countries that had not received budget support. As was the case for the PRSCs (see previous section), the decline does indeed seem to be *marginally* greater for countries that did receive budget support.[78] Most of the differences are statistically significant. On average, poverty and income inequality declined more in countries with extensive budget support.

There are several *attribution problems* at play here though. First, there is the possibility that countries received budget support *because* it was difficult to reduce poverty. Countries that were successful in that endeavour, such as Vietnam and to a lesser degree Ghana, are at risk of losing part of their aid for precisely that reason. Conversely, countries may also have received budget support *because* they implemented good poverty reduction policies. In that case, there is also a selection bias, because money went to countries that already had more chance of reducing poverty. The first problem leads to underestimating the impact; the second to overestimating it.

[78] The analysis has a number of data-related limitations, because poverty data is only available for several years in all the countries. To solve this problem, this analysis compares the first year with data and the last year with data (between 1997 and 2009). There are no systematic differences on this point between countries that did receive budget support and countries that did not. The average first year for both groups is 2000 and the average last year 2007. The changes were calculated over a period of seven years for all countries. The total sample survey is small, however (N=71, of which 23 GBS countries).

Table 7.2: Income and poverty in GBS and non-GBS countries (2000–2007)

	Number of countries	First year (2000)	Last year (2007)	Change 2000–2007	Sign.
GINI:					
GBS countries	23	41.6	39.2	-3.2	*
Other countries	48	43.4	42.4	-1.0	
Income share of lowest 20%:					
GBS countries	23	6.1	6.7	0.7	*
Other countries	48	5.6	5.9	0.3	
Percentage of poor (US$1.25 a day)					
GBS countries	23	48%	36%	-11%	**
Other countries	48	19%	13%	-6%	
Percentage of poor (US$2 a day)					
GBS countries	23	68%	55%	-11%	
Other countries	48	35%	27%	-7%	
Poverty gap (US$1.25 a day)					
GBS countries	23	20%	14%	-6%	***
Other countries	48	7%	4%	-2%	
Poverty gap (US$2 a day)					
GBS countries	23	35%	26%	-8%	***
Other countries	48	15%	10%	-4%	

*= p<10%; **=p<5%; ***=p<1%.
Source: OECD/DAC, WB (WDI); adapted by IOB.

We conducted a multivariate analysis, with limited data available, in which we also instrumented for other aid modalities.[79]

A standard regression analysis (OLS) shows no or barely any impact of aid on poverty. After instrumentation, however, the results do show a positive impact: US$10 of aid per inhabitant helps reduce the percentage of poverty by 0.1 percentage points. However, it is impossible to indicate whether budget support was more or less effective than other forms of aid.

79 Because of the high correlation between budget support and other forms of aid, we have taken them together. See chapter 1 for the instrumentation and annex V for an explanation.

Table 7.3: Relationship between budget support and percentage of poverty (at US$2.00; 2002–2010)*

	OLS			2SLS		
	Coefficient	t-value	Signif.	Coefficient	t-value	Signif.
GDP growth per capita	-0.271	-4.23	***	-0.25	-4.64	***
ODA in US$ per inhabitant	-0.009	-1.74	*	-0.011	-5.46	***
Percentage of poverty original situation*	-0.018	-3.02	***	-0.017	-3.47	***
Constant	0.893	2.13	*	0.866	2.62	**
R^2adj	0.30			0.49		

*= *p<10%; **=p<5%; ***=p<1%.*
* *Average annual change*
N=71

Table 7.4: Relationship between budget support and poverty gap (at US$2.00; 2002–2010)

	OLS			2SLS		
	Coefficient	t-value	Signif.	Coefficient	t-value	Signif.
GDP growth per capita	-0.110	-2.50	**	-0.102	-2.50	**
ODA in US$ per inhabitant	-0.006	-1.73	*	-0.006	-3.90	***
Percentage of poverty original situation*	-0.032	-4.68	***	-0.031	-4.99	***
Constant	0.476	1.77	*	0.743	1.84	*
R^2adj	0.29			0.40		

*= *p<10%; **=p<5%; ***=p<1%.*
* *Average annual change*
N=71

Between 2002 and 2010, 35 countries received an amount of budget support that was at least 0.25% of GDP. This came to a total of US$22.7 billion. These countries' population amounted to 358 million people (average over the years). According to the above calculations, budget support – in addition to other impacts! – should have helped reduce the number of people living below the poverty line by 2.5 million people (at a poverty level of US$2 a day). In addition, it helped reduce poverty levels for a much larger group of households that lived below the poverty line. The analysis comprised 71 countries with a total population of about 2.9 billion people in around 2000. The poverty line was about 60% on average, and the poverty gap 33%. According to calculations, US$100 of budget support (per person) reduced the poverty gap by 0.6 percentage points, so that the *direct*

contribution to the reduction of the poverty gap can be estimated at 0.4 percentage points (of a total of 8%).[80]

The question is whether it is realistic to expect more substantial poverty effects in the short term. Budget support for the 35 countries mentioned above amounted to an average of US$7 per inhabitant per year between 2002 and 2010. If it all had reached the poorest, then it would have amounted to US$14 per year. A large part of the aid was in fact not aimed at improving the incomes of the poorest, however. The resources for budget support – setting aside potential misuse – were mainly used to:

- improve services that also benefit poorer groups (particularly health care); and
- make investments that will have a positive effect on poverty reduction in the long term (particularly education).

The effects of this were much bigger.

Second, the poverty gap (the distance to the poverty line) can obscure our understanding of poverty reduction. In *Zambia*, the percentage of households between 1998 and 2006 living below the poverty line barely decreased, despite relatively high economic growth in the new millennium. Extreme poverty, however, decreased more (De Kemp, Faust and Leiderer 2011, p. 203). Governments and donors often focus – because it is easy to interpret – on the percentage of people or households that live below a certain poverty line. But when the poverty gap is large, then several years of economic growth will not suffice. A large group does benefit from budget support, but not enough to reach an income level above the poverty line.

Another reason why poverty is declining slowly is the high population growth in many African countries, where it is between 2.5% and 3%. This absorbs a large part of the economic growth, which limits the growth per capita of the population.

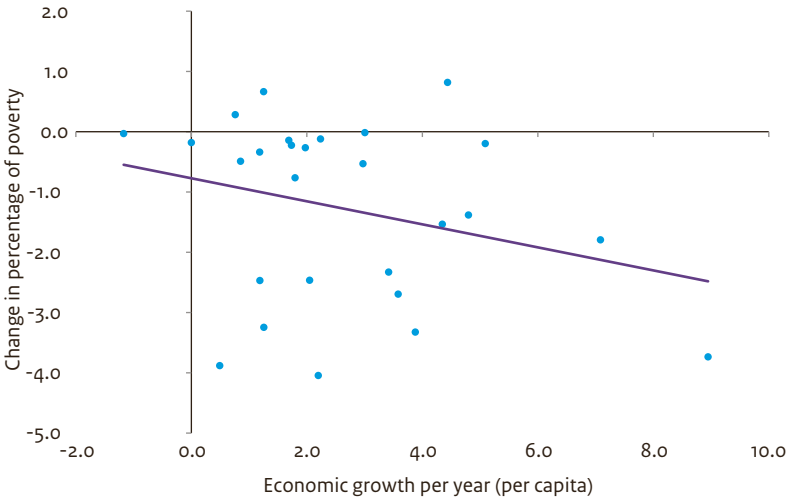
Dalgaard and Hansen (2010) estimated that if the all the aid in the last 30 years had been used effectively to increase investment, then this would have only led to an increase in income per capita of the population over 30 years of 6%–10% (see also Dalgaard and Erickson 2009). Ravallion (2001) estimated that a 1% increase in economic growth would reduce poverty by 2%. Besley and Burgess (2003) found an elasticity of 0.75 (and for sub-Saharan Africa alone an elasticity of 0.49).

The differences between countries were also considerable. In some countries with relatively little budget support (such as Vietnam), poverty declined substantially, while the decline in other countries (such as Tanzania and Zambia) was limited. Much depends on whether budget support is embedded in the socio-economic policy and socio-economic developments in the partner country. Both high economic growth and high growth elasticity are of paramount importance for a substantial reduction of poverty.

[80] This figure is an underestimation, incidentally, because poverty figures are expressed in purchasing power parities, and the purchasing power of a US dollar is much higher in many developing countries than in western countries.

Figures 7.2 and 7.3 show the relationship between economic growth (per capita) and a decline in the percentage of poverty in low- and low middle-income countries. The growth elasticity of poverty seems to be slightly greater in countries that received budget support.

Figure 7.2: *Economic growth and development of poverty in countries without budget support (2000–2007)*



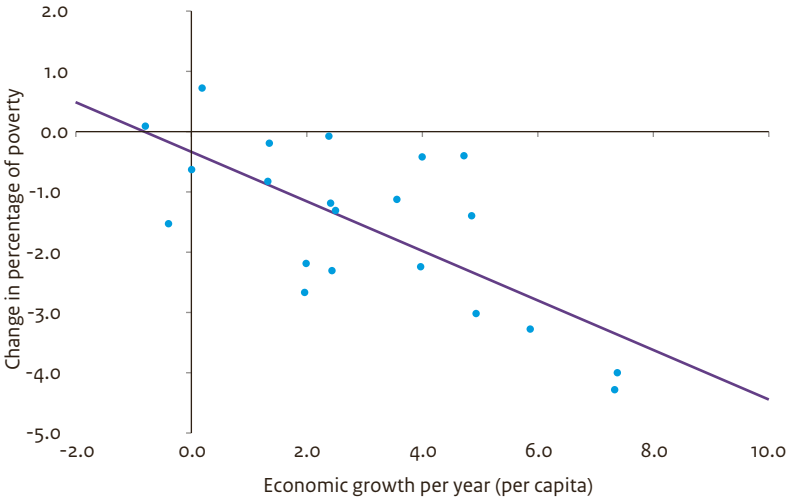
Source: World Bank (WDI); adapted by IOB.

The result depends, however, on the exclusion of two outliers (strongly deviating observations): Armenia and Georgia. These two countries combined high economic growth with an extremely limited reduction of poverty. If these two countries were included in the figure, the difference would largely disappear.[81] Combining the data in both figures produces somewhat more robust estimates. Economic growth of 1% a year then results in an average decline of the poverty percentage of 0.33 percentage points (depending on the level of poverty percentage, that is an elasticity of approximately 0.5–1.0).

The three countries in figure 7.2 where poverty increased are Yemen, Nigeria and Mauritania. The group of countries with a relatively strong decline of poverty include Guinea, Indonesia, Pakistan and Kyrgyzstan, all of which did receive some budget support. In the cases of Pakistan and Indonesia, it concerns considerable amounts in the absolute sense. These amounts are only limited in relation to these countries' GDP. Figure 7.3 puts Madagascar in a negative highlight. The Central African Republic also deviates from this trend line in a negative sense. Poverty there barely declined between 1999 and 2006. Vietnam is a positive highlight, on the other hand. There, poverty declined more than could have been expected by the estimated relation.

[81] Total budget support to Armenia was relatively limited, however.

Figure 7.3: *Economic growth and development of poverty in countries with budget support (2000–2007)*



Source: World Bank (WDI); adapted by IOB.

7.2.4 The six country case studies

The six case studies show a mixed picture at best. It is clear from a number of evaluations that despite economic growth the incomes of the poorest in several African countries (including Zambia and Tanzania) have barely improved. This conclusion is especially true for rural areas. Urban areas have been the primary benefiters of economic growth.

The evaluation of budget support to *Zambia* concluded that government policy was not very effective in fighting poverty in rural areas. The largely unproductive agricultural sector there lagged behind, and this was an important reason why households did not benefit more from economic growth. The government had put, for political reasons, almost all its money in the (maize) fertiliser subsidy basket, but this mainly helped wealthier farmers and not the poorest. The Zambian government also invested in trunk roads but much less in connections in rural areas, while these local roads are precisely what is important for the economic and social inclusion of these underdeveloped regions. The evaluation also concluded that while it seemed as if a great deal of financial aid was being offered, this was actually not the case if viewed in terms of per capita of the poorer segment of the population. Budget support amounted to approximately US$20 per poor inhabitant per year. In that sense, the expectations were not very realistic to begin with.

Poverty did not decline substantially in *Tanzania* either, despite an average annual economic growth of 7%. An important explanation for this is that the growth took place mainly in the mining, construction, telecommunications and banking sectors, where few people work. The largest part of the professional population works in agriculture, and that sector grew an

average of 4%-5% a year. High population growth limited the impact of growth per capita of the population.

The percentage of households in *Ghana* below the poverty line increased until the end of the 1990s, even though extreme poverty did decline. During this last decade, the percentage of households below the poverty line decreased. As was the case with Zambia, for example, there are still major differences at the regional level. The south benefitted from mining, a better infrastructure and improved services, while the underdeveloped agricultural sector in the north was unable to attract investment. The evaluation of budget support from 2007 had no recent data on the development of poverty in Ghana. The consultants did conclude, however, that although there was some evidence suggesting that budget support had a positive impact on pro-poor expenditures, the institutional environment was too weak to rely on positive poverty effects (Lawson et al. 2008, p. 132).

Table 7.5: Poverty development in six case study countries

	First year	Last year	First year	Last year	Change	Average per year
Total percentage poor (US$ 1.25 a day)						
Ghana	1998	2006	39%	28%	-11%	-1.4%
Mali	2001	2010	61%	50%	-11%	-1.2%
Nicaragua	2001	2005	48%	46%	-2%	-0.5%
Tanzania	2000	2007	60%	57%	-3%	-0.5%
Vietnam	2002	2008	32%	18%	-14%	-2.3%
Zambia*	1998	2006	56%	49%	-7%	-0.9%
*Total percentage poor**						
Ghana	1998	2006	40%	29%	-11%	-1.4%
Mali	2001	2010	56%	44%	-12%	-1.3%
Nicaragua	2001	2009	46%	45%	-1%	-0.1%
Tanzania	2000	2007	36%	34%	-2%	-0.3%
Vietnam	2002	2008	29%	15%	-14%	-2.3%
Zambia	1998	2010	73%	61%	-12%	-1.0%
*Percentage rural poor**						
Ghana	1998	2006	50%	39%	-11%	-1.4%
Mali	2001	2010	65%	51%	-14%	-1.6%
Nicaragua	2001	2009	68%	68%	0%	0.0%
Tanzania	2000	2007	39%	38%	-1%	-0.1%
Vietnam	2002	2008	36%	19%	-17%	-2.8%
Zambia	1998	2010	83%	78%	-5%	-0.4%

* *Obv nationale armoedecijfers.*

Poverty declined significantly in *Mali* between 2000 and 2010 (from 56% to 44%), and rural poverty decreased as well. Gold mining and agricultural production (especially cotton and rice) seemed to be important factors, though poverty in one of the regions with mines remained as high as before. If budget support played a role, then it was mainly in terms of its impact on the government budget. The sluggish reform of the agricultural sector, high population growth and the political situation prevented the further decline of poverty.

Budget support had little impact on poverty reduction in *Nicaragua*. To begin with, fighting poverty was not Bolaños' top priority. It was more of a priority for Ortega, but the Netherlands and other donors suspended budget support during his administration (though for other reasons). Economic growth was about equal under both presidents, but insufficient to substantially reduce poverty. Poverty even increased in certain years despite economic growth (IOB 2008). Between 2005 and 2009, extreme poverty in rural areas did drastically decline, which is possibly the result of one of the programmes implemented by Ortega's government, but it could also be the result of the social safety net that was established in 2005 and 2006 or the rising price of coffee from 2006 onwards.

Arndt et al. (2010b) analysed the causes of differences in poverty developments between *Vietnam* and Mozambique. The poverty growth elasticity during the period 1997–2009 was much higher in Vietnam than in Mozambique, which means that economic growth in Vietnam was much more 'pro poor'. Farmers in Vietnam were able to take much more advantage of the growth in urban centres than was the case in Mozambique. An explanation according to Arndt et al. is that Vietnam has a much more developed infrastructure that connects urban growth centres and agricultural production zones (p. 11). Urban transport services benefited in particular from the rise in agricultural revenue in Mozambique. A second explanation is the much lower level of education in rural Mozambique: 'A continuation of existing policies to promote widespread education in Mozambique would therefore narrow the skills premium currently earned mainly by urban households, while also enabling poorer rural households to participate more in the growth process' (Arndt et al. 2010b, p. 11). The decline of income poverty in Vietnam, incidentally, was more the result of high economic growth than budget support. Budget support had little impact on either.

In addition to Vietnam, *Rwanda* has also recently joined those countries that are making progress in their fight against poverty. Poverty figures there decreased from 57% to 45% between 2005 and 2010 (National Institute of Statistics of Rwanda, 2012). The decline was especially marked in rural areas (from 62% to 49%). Extreme poverty decreased from 36% to 24% (in rural areas from 40% to 26%). The improved poverty figures are mainly the result of the following factors:

- a rise in agricultural production;
- increased commercialisation of agriculture (from 18% to 25%). Both factors led to better incomes for farmers;
- better employment opportunities outside the agricultural sector; and
- the increased importance of private and public transfers of income.

Conclusion

Not only is the level of economic growth important for poverty reduction, so is its composition (Loayza and Raddatz 2006). In sectors such as mining, economic growth hardly contributes to poverty reduction. Poverty especially decreases when growth is concentrated in labour-intensive sectors such as agriculture. Of the six case study countries, poverty decreased the most in Vietnam by a long chalk. This was not the result of the limited budget support received by the country but much more a combination of high economic growth and high growth elasticity of poverty. Poverty declined in Ghana and Mali as well, both in the cities and in the urban areas. This elasticity was low in Zambia, Tanzania and Nicaragua. In Zambia, that was partly the consequence of a failing poverty policy; for a long time, the Nicaraguan government showed little interest in developing a targeted poverty reduction policy.

7.3 Expenditures for public services

7.3.1 Results of evaluations

Boone (1996) was one of the first to examine the impact of aid on services. He argued that aid did not focus on economic growth at all, for two reasons: 1) according to the author, poverty is not caused by a scarcity of capital and 2) aid takes away the incentive to end policies that distort the market. Boone did find that development aid had a positive impact on government consumption, but according to him this increase did not benefit the poorest segment of the population. Aid did have a significant impact on child mortality or enrolment in education. An important reason for this, Boone argued, is that aid was set up in such a way that it did not provide autocratic regimes with any incentive to improve these indicators. The child mortality rate in democratic regimes, on the other hand, was on average 30% lower. Boone concluded that aid can only be effective a) if it is given to democratic regimes (where voters can punish government policy, b) in the few cases in which aid is not fungible, or c) if aid is provided on the *condition* that policy and/or political reforms take place.[82]

More recent evaluations of budget support reached a more positive assessment, which might also be linked to better socio-economic policies in many developing countries (Radelet 2010). The *Joint Evaluation of General Budget Support* (IDD and Associates 2006) concluded that budget support did in fact help increase spending on the social sectors.[83] Additional resources led to an extension of services, especially in health care and education. According to the consultants, this was mainly the result of pressure from citizen demand,

[82] This conclusion corresponds with later findings by Burnside and Dollar (see chapter 6) and Kosack (2003), for example. Evidence seems to be increasingly suggesting, however, that this position is untenable (cf. developments in China and Vietnam), even though it is still clear that countries with extremely poor governance also focus little on development (see also chapter 5 for this discussion).

[83] The evaluation included Burkina Faso, Malawi, Mozambique, Nicaragua, Rwanda, Uganda and Vietnam. Malawi and Nicaragua had not been receiving budget support long enough for anything to be said its impact on government spending.

which underscores Boone's argument. An example is the abolition of school fees in Ugandan primary schools in 1997. President Museveni had made this an important issue in his bid for re-election in 1996 (IOB 2008). Based on evaluation of budget support in Zambia, Mali and Tunisia, Caputo, De Kemp and Lawson (2011) concluded that budget support can also have a leverage effect and that social expenditures can be even greater than the resources of budget support. One explanation is that with budget support, donors conduct the policy dialogue at another level, one where decisions about allocation take place.

With regard to earmarked project aid, budget support led to better allocation of funds, in which a given activity no longer received money because there was money available for it, but because the activity itself was a priority. As a result, the modality made it possible to weigh the pros and cons of capital expenditure and current expenses (the latter category could often not be financed from project funds) (IDD and Associates 2006, pp. 50-51; see also NAO 2008, p 14). IEG (2010) came to similar conclusions. IEG signalled a problem in health care, namely that a large percentage of spending was 'off budget' (for example in Ghana and Mozambique). The World Bank's evaluation department concluded that this prevented the efficient allocation of funds in the sector. The drawback of budget support, as was remarked in the Uganda sub-study of the Joint Evaluation of General Budget Support, is that additional funds take away the incentive to maximize operational efficiency.[84]

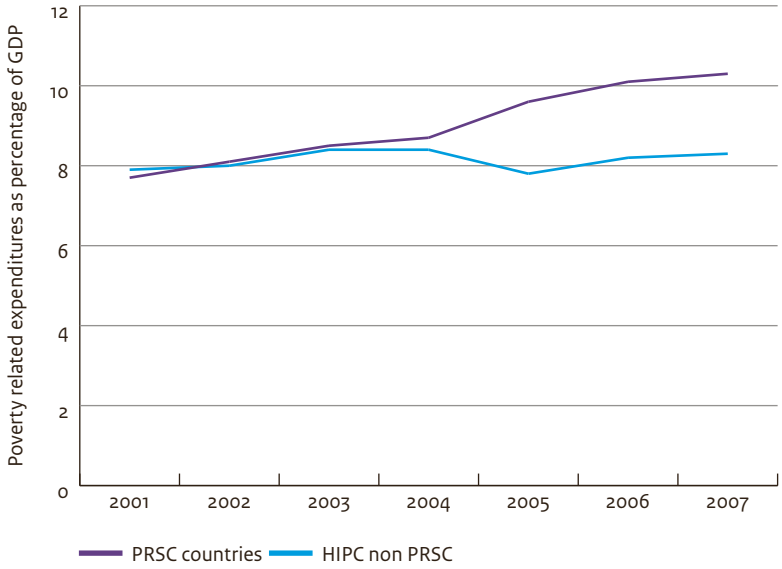
ODI and Mokoro studied the impact of sector budget support in six countries (Mali, Mozambique, Rwanda, Tanzania, Uganda and Zambia) and five sectors (health, education, agriculture, roads and local government) (Williamson and Dom 2010). The consultants concluded that this aid contributed to the extension of public services in nine of the ten researched case studies, with 10%-40% of the expenditures being financed.[85] According to the consultants, sector support led to a reorientation of sector funds to better services by means of the policy dialogue and earmarked funds.

The World Bank's evaluation department (IEG 2010) compared the development of poverty expenditures in countries with budget support (Poverty Reduction Support Credits, PRSC) with other countries, whose debts were waived in the framework of the HIPC initiative. This comparison showed that poverty-related expenditures increased more in PRSC countries (see figure 7.4). Both groups of countries developed differently after 2004.

[84] This argument is just as valid for off-budget projects.

[85] Only in the agricultural sector in Mozambique did budget support go hand in hand with a decline of domestic resources.

Figure 7.4: *Development of poverty-related expenditures as % of GDP for PRSC countries and other HIPC countries**



* *PRSC countries: Benin, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Malawi, Mali, Mozambique, Nicaragua, Rwanda, Senegal, Tanzania and Uganda.*

HIPC (non-PRSC) countries: Bolivia, Cameroon, The Gambia, Mauritania, Niger, Sao Tome and Principe and Sierra Leone.

Source: IEG 2010, Annex A6.7, p. 49.

IOB estimates point in the same direction. Chapter 4 already discussed the impact of budget support on government expenditures. Individual evaluations showed that these expenditures particularly benefited social services.

An IOB analysis shows that between 2000 and 2010, government expenditures in 'GBS countries' on health care as a percentage of GDP increased by more than one percentage point, while it did not increase by more than 0.2 percentage points in 'non-GBS countries'. A one percentage point increase (of GDP) in budget support leads to an increase of government expenditures on health care of 0.14–0.37 percentage points. The impact on education seems even greater and amounts 0.16–0.81 percentage points.[86] These findings also correspond with the conclusion in chapter 4 that on average 60% of budget support is spent immediately. The uncertainty margins are substantial, however, which is a consequence of the small number of countries in the analysis and the substantial differences (also between countries with a great deal of budget support).

[86] The estimated coefficient, however, is not significant, which is mainly the consequence of a much lower number of observations (due to a lack of data on education). The coefficient does correspond with the results of individual case studies though.

Table 7.6: Relationship between budget support and social expenditures (2002–2010)

	Health care	Signific.	Education	Signific.
Fixed effects				
GDP growth	-0.02 (-1.54)		-0.02 (-1.16)	
GBS as % of GDP	0.14 (1.36)		0.16 (0.62)	
Ln GDP per capita	-1.11 (-1.81)	*	-4.86 (-3.14)	***
Kaufmann score	0.62 (2.36)	**	1.44 (2.34)	**
Trend	0.10 (2.94)	***	0.25 (3.03)	***
Constant	10.10 (2.47)	**	34.36 4.42)	***
R^2 (within)	0.14		0.27	
N	729		295	
Countries	96		72	
2SLS				
GDP growth	-0.02 (-1.78)		-0.02 (-1.84)	*
GBS as % of GDP	0.37 (3.13)	***	0.81 (1.80)	*
Ln GDP per capita	-0.97 (-1.68)	*	-4.38 (-5.01)	***
Kaufmann score	0.55 (2.49)	**	1.32 (2.59)	**
Trend	0.09 (3.26)	***	0.23 (4.50)	***
Constant	9.04 (2.35)	**	33.60 (5.74)	***
R^2 (within)	0.20		0.37	
N	722		293	
Countries	95		71	

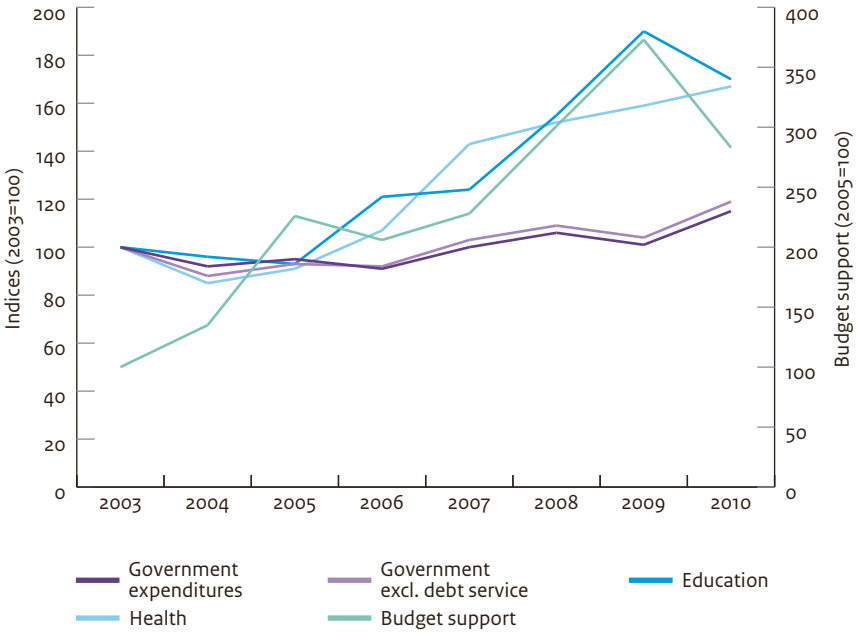
*t-values in parentheses (based on robust standard errors); *= p<10%; **=p<5%; ***=p<1%.*

7.3.2 The six country case studies

A number of separate, individual case studies (Mali, Tanzania and Zambia) also show that budget support has helped increase funds for the social sectors. The conclusion of these evaluations is that the expenditures in these sectors increased more than may have been expected based on additional funds alone. This suggests the presence of a leverage effect. Public expenditures on health care and education in *Tanzania* quadrupled in ten years' time. Expenditures on health care and education also increased considerably in *Ghana* as well after it started receiving budget support. An evaluation from 2007 concluded that the pressure to raise salaries in the education and health care sectors played a particularly important role in this. Budget support did subsequently make this increase in spending possible, whereby the level of services could also be extended (Lawson et al. 2008).

The example of *Zambia* is also illustrative. According to donors, the Zambian government spent too little on education and health care in particular between 2000 and 2005. After the Memorandum of Understanding (MoU) for budget support was signed in 2005, expenditures in these sectors increased drastically, much more than in other sectors. Economic growth, debt relief (in 2005) and even the amount of budget support were insufficient to explain governments' own expenditures in these sectors. The evaluation concluded that the combination of budget support, GBS policy dialogue, sector dialogue and ownership effectively contributed to increasing funds for these sectors.

Figure 7.5: *Rising expenditures on education and health care in Zambia (2000–2010)*



Source: De Kemp, Faust and Leiderer (2011); adapted by IOB

According to the report, budget support can be effective providing that a) the recipient government shows sufficient ownership and b) donor and recipient preferences are aligned. This conclusion corresponds with findings by Cordella and Dell'Ariccia (2003). Budget support had a positive impact on expenditure and services in sectors where the government showed a high degree of ownership (especially in education and health care). The instrument was not effective, however, in achieving reforms in sectors where government and donor ideas about priorities and strategic choices strongly diverged (such as in the agricultural sector, where the government held on to corn subsidies for political reasons). The Zambian government did not assume much ownership of rural water supplies in the sense that they showed little initiative and did not free up funds. The evaluation concluded that in this area a transfer of project resources to budget support would presumably only lead to a decline of the total resources for rural water supplies.

Nevertheless, the role budget support played in increasing expenditures on the social sectors was not always equally evident. In *Vietnam*, expenditure on poverty between 1997 and 2004 increased substantially. Various evaluations, however, did not reach the same conclusion about the role of budget support. According to Bartholomew et al. (2006), the PRSCs did not influence expenditures on poverty because they increased more than was agreed in the evaluation framework.[87] Grawe (2010) concluded, on the other hand, that the PRSCs did have some influence on the increased expenditures in the social sectors and on the growing focus on poverty in the budget (see also IEG, 2010). In Vietnam, the policy dialogue in the education sector was fairly effective because there was a great deal of agreement among donors and with the government, and also because the government was clearly efficiently organised. Donors were less in agreement when it came to the health care sector, and there was less agreement between donors and the government in the water sector, and the division of tasks and authority were less clear.

7.3.3 Quality

Different evaluations do suggest that the extension of services was at the expense of quality (IDD and Associates 2006; NAO 2008; IEG 2010; Williamson and Dom 2010). The evidence for this is often weak, however. The conclusion of the British National Audit Office (NAO), for example, is based on the 'example' of Ethiopia, where, according to the NAO, the results in the education sector had not improved in four years. For IDD and Associates, Uganda served as an important example. The level of education there is indeed low. However, it is incorrect to suggest that the quality of the education suffered after a strong increase in school enrolment. Neither national nor international tests provide evidence for this (IOB 2008). Classes may be far too overcrowded, but the teacher–pupil ratios and the classroom–pupil rations have improved.

[87] This conclusion leaves open the possibility that budget support had a financing effect and thus did in fact have a positive impact on the overall expenditure level.

Equally important for an adequate evaluation is the finding that the population that takes advantage of the extension of services has changed significantly. Investments in education and the abolition of school fees enabled the poorer segments of society and rural areas to gain access to education in many countries. Now, younger people, whose parents never enjoyed an education and who had no books or electricity at home, were going to school. This had a significant impact on average exam results: pupils in poor, rural areas have lower averages on test and exam results than those in wealthier urban areas. There is another important factor as well: the language of the former coloniser is often the official language in many African countries, whereas the inhabitants of rural areas do not speak English, French or Portuguese. Children are rarely confronted with the 'national' language outside of school time, if at all. Teachers often hold their lessons in the local language, partly because they do not speak the national language at all or not well (for a detailed analysis, see IOB 2008 and De Kemp, Faust and Leiderer 2011).

These findings do not alter the fact that there are major problems involved in improving the quality of services. One of the causes is inadequate local capacity (not only in Uganda, but also in Rwanda, Burkina Faso, Mali and Zambia, for example). Williamson and Dom (2010) argue that this can be explained by the lack of attention for what they call the 'missing middle': the capacity and quality of the local management levels, staff management, the actual service and the monitoring of this service. Different factors are responsible for this. The consultants mention two:

a sector ministries, and especially planning management, are mainly staffed by economists and other financial experts, who have little contact with the actual service providers; and
b embassy staff posted abroad often have insufficient knowledge of the local situation.

Both these factors mean that insufficient attention is being devoted to the quality of the administration of these services. An additional problem is that there is a shortage of well-schooled staff in many countries. As a result, better educated people move to the capitals and look for work there, thus damaging the quality of services at the local level.

General and sector budget support have drastically reduced the immediate involvement of embassy staff in services, and the sector dialogue and central technical support, mainly aimed at financial management (curtailing fiduciary risk), have received more attention at the expense of administrating services. The Performance Assessment Frameworks are insufficiently geared towards priority bottlenecks in the implementation of services (IEG 2010). Quality indicators are often not immediately visible in the improvement of the results indicators, so that the recipient government has insufficient incentive to tackle existing bottlenecks. Donors and governments have mainly focused directly on the MDGs-related result indicators, and were mainly concerned with investing in hardware: more schools, classrooms, teachers, health centres and medicine, but less in the organisation and management of them. Decentralisation was an objective without any guarantee of quality at the local level (see also Lessmann and Markwardt 2010). Nevertheless, it appears to be possible to considerably improve management at the local and administrative level and thus achieve major improvements (IOB 2008). Donors, after all, have unrealistic

expectations of these limited resources (IEG 2010; Williamson and Dom 2010; De Kemp, Faust and Leiderer 2011).

Williamson and Dom identify a number of conditions for the improvement of sector support's effectiveness, including:

1 budget support has to make the provision of public services a priority, especially at the level of immediate implementation;
2 budget support has to focus on the critical factors of service delivery; and
3 there have to be sufficient funds to make an extension of the services possible while at the same time maintaining or improving quality and sustainability.

7.4 Use and impact of services

7.4.1 Country comparative research

Following Boone (1996), Masud and Yontcheva (2005) examined the hypothesis that a large part of aid focuses on improving living conditions and achieving the MDGs. In doing so, they use the same indicators as Boone (for which a relatively large amount of information is available): child mortality and education, measured as the literacy rate. They made a distinction between two different channels: bilateral aid and aid via NGOs. The researchers concluded that aid via NGOs is especially effective in combatting child mortality. For the literacy rate, they found no significant differences between bilateral aid and support by NGOs, or to put it more accurately, neither forms aid had a significant impact.[88]

Masud and Yontcheva's findings were refuted by the results of an *inventory* drawn up by Oxfam International (2008). In this document, the organisation shows that the main recipients of budget support (Ghana, Kenya, Madagascar, Mali, Mozambique, Niger, Rwanda and Zambia) made the most significant progress in the area of primary education and

[88] Masud and Yontcheva used data from the period 1990–2001. This time frame is completely unsuitable for measuring the impact of aid on the literacy rate. First, it is much too short a period for measuring extensive impacts. It therefore would have been better to only examine the degree of literacy among younger people or compare different age cohorts with each other. The researchers saw this as a 'possible explanation', incidentally. Second, many developing countries drastically economised on education expenditures in the 1990s – partly under pressure from the IMF – and only launched their reform programmes at the end of the 1990s. The researchers offered a number of potential explanations for the different measurements of the impact on child mortality. These explanations point to a selection bias, such as the hypothesis that NGOs focused more on countries with high child mortality rates, while bilateral aid focused more on countries where that is less the case. They concluded that 'while official donors have adopted reaching the MDGs as their official policy, their aid allocation pattern is not consistent with their avowed objectives' (p. 20). A subsequent conclusion is that '…bilateral aid seems to be fungible and increases in aid don't seem to be reflected in health expenditures (ibid, p. 20). Results of case studies, however, do point to the additionality of bilateral programme aid (see above). The real conclusion has to be that the researchers' model was inadequate for measuring the intended impacts.

health care, partly thanks to higher expenditure in these sectors.[89] The Oxfam findings were confirmed in a study by Beynon and Dusu (2010), though these authors were much more cautious in their pronouncements. The two staff members of the European Commission analysed the improvements made in several of the MDGs in different groups of countries between 2002 and 2007. They divided aid-receiving countries into three groups: countries with little budget support, countries with moderate amounts of budget support and countries with substantial budget support (measured between 2002 and 2007).[90] For the impacts, they looked at improvement in primary education enrolment, the ratio between girls and boys in primary schools, the decline of child mortality, access to drinking water and the UN Human Development Index (HDI).

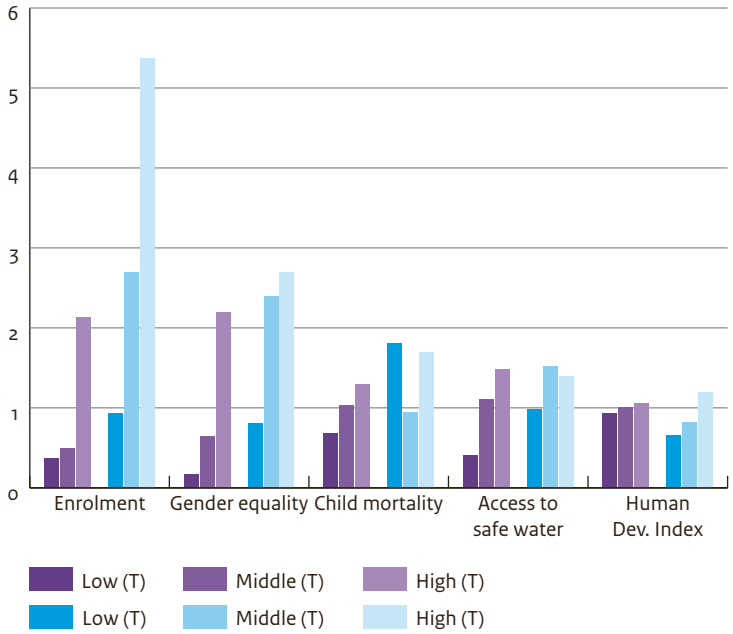
Figure 7.6 presents the most important results from Beynon and Dusu's report. The different groups (see above) are referred to as low, middle and high, which indicates how much budget support a country received. In addition, all the scores for the various MDG objectives can be easily compared because they are expressed with the same units, in which a score of 1 indicates the *average* improvement in all the countries. For example, school enrolment improved by 1.1% in the 'low' category, by 1.5% in the 'middle' category and by 6.5% in the group that received a relatively high amount of budget support. The average across the three groups is therefore 3%. This percentage is standardised so that all the MDGs can be compared (because, for example, child mortality was expressed as deaths per 1,000 children). A value of 5.4 for countries with a lot of budget support in Africa therefore means an increase in school enrolment of 5.4 × 3% = >16%. In this way, the relative impact of budget support is the same for every indicator.

The variable 'gender equality' indicates the change in enrolment of girls vis-à-vis boys. Countries with a relatively large amount of general budget support had significantly better results in the MDGs for primary education, gender equality in education, child mortality and access to drinking water than countries that received little budget support.

89 This IOB policy review does not consider Kenya a large GBS recipient. Between 2002 and 2010, Kenya received budget support in the amount of 0.1% of its GDP, whereas GBS was not much more than 1.5% of total aid either.

90 The researchers use the GBS/ODA ratio and the GBS/GDP ratio for this categorisation. They do not combine the ratios, however, but calculate the impact for both separately.

Figure 7.6: *Improvement in a number of indicators according to size of budget support (2002–2007)*



Low= little/no budget support; Middle= average level of budget support; high= substantial budget support.

T= all countries receiving aid; A=Africa

Source: Beynon and Dusu (2010); adapted by IOB

School enrolment improved by more than a percentage point in countries with little budget support. This was 6.4 percentage points in countries with a relatively high amount of budget support and even more than 16 percentage points for African countries with a relatively high amount of budget support. The 'gender disparity index' in primary schools barely improved in countries with budget support, but did improve by five percentage points in countries that received substantial budget support. Here too, the impact was greater on African countries (6.3 percentage points). The differences in child mortality *seem* smaller, but are statistically significant. Mortality declined in countries that received the least budget support by less than 9,000 children, while that figure was almost twice as high in countries with a relatively high amount of budget support. There was a striking phenomenon in Africa in which both the countries with the least and the most budget support saw the greatest improvements on this point. The figures for access to safe drinking water were 1.3 and 4.7 percentage points respectively. The HDI scores were not far apart, but here too the differences were significant. Annex VI contains Beynon and Dusu's detailed results.

IOB examined more closely the relationship between budget support and changes in the UN development index, using its own categorisation of GBS and non-GBS countries (see table 7.7). This analysis shows that between 2000 and 2010 the development index of GBS countries rose more than that of other countries. The differences are significant (t=2.10; p=0.039).

Table 7.7: Budget support and changes in the HDI score (2000–2011)

	Number	Index 2000	Index 2005	Index 2011	Change 2000–2011
Countries with budget support	26	0.426	0.460	0.493	0.066
Countries with little or no budget support	61	0.545	0.577	0.601	0.056

Source: UN; adapted by IOB

An analysis that relates the size of budget support to changes in the HDI score shows a significant impact, also after checking for economic growth, good governance and debt relief:

Table 7.8: Relationship between budget support and HDI index (2000–2010)

	Coefficient	t-value	Significance
GDP growth (2000–2010)	0.035	7.86	***
ΔKaufmann 2000–2010	0.001	0.24	
Average GBS 2002–2010	0.007	2.58	**
Average other aid*	0.000	-0.99	
HIPC countries	-0.002	-0.47	
Constant	0.037	10.20	***

*Significance levels: *<10%; **<5%; ***<1% (based on robust standard errors).*

R^2adj=0.54; N=85

The PRSC evaluation of IEG (2010) showed similar results. IEG examined differences between PRSC countries and non-PRSC countries in terms of changes in MDG indicators. The table below compares PRSC countries to non-PRSC countries that have similar scores in good governance. This reduces the risk of potential selection effects.[91]

[91] Selection effects could have materialised, for example, if the World Bank were to give these credits to countries that are already making more of an effort to achieve the MDGs.

Table 7.9: Improvements in MDG indicators for PRSC countries and comparable countries (1995–2006)

	1995	2000	2006	Change 2000–2006
*Enrolment in primary education:***				
PRSC	62.8	68.9	79.1	10.2
Comparable countries	67.6	75.1	80.0	4.9
*Enrolment in secondary education:***				
PRSC	31.2	40.1	49.3	8.8
Non-PRSC**	36.4	43.8	55.1	11.3
Infant mortality (per 1,000):				
PRSC	76.2	67.1	58.2	-8.9
Comparable countries	74.6	68.1	61.3	-6.8
Child mortality (per 1,000):				
PRSC	115.3	101.3	87.5	-13.8
Comparable countries	122.8	111.1	99.7	-11.4
Access to safe drinking water:				
PRSC	64.6	68.9	73.9	5.0
Comparable countries	68.8	71.9	74.7	2.8
Access to sanitation:				
PRSC	38.4	41.5	46.2	4.7
Comparable countries	51.9	54.0	54.5	0.5

* *Non-PRSC countries with a CPIA score of at least 3.0 (37 countries). There were 52 non-PRSC countries.*

** *For education data for 1991 instead of 1995.*

*** *No data for the group of comparable countries.*

Source: IEG 2010, Annex A6.7, p. 46.

Based on that, IEG determined that PRSC countries score better in all the examined indicators, with the exception of access to secondary education. This could point to the strong fixation of donors on primary education. Enrolment in primary education improved more in PRSC countries, child mortality declined more and access to safe drinking water and sanitation increased more. In most cases, the differences were great as well. The evaluation revealed that improvements were also greater during the period that countries received budget support for these things.

Table 7.10 provides an analysis of the relationship between general budget support (measured as the total amount of budget as a percentage of GDP) and changes in a number of social indicators. The results are based on regression analyses, in which the impact of debt relief (HIPC), economic growth, other ODA expenditures and better governance (as measured by the Kaufmann scores) were checked as well. One potential problem with these

analyses is the correlation between budget support and other expenditures. This is why the first column presents the impact in which other ODA has not been included as a control variable. The actual impact is presumably in between both values: on the one hand, the inclusion of other ODA as a control variable may lead to an underestimation of the impact as a result of multicollinearity, but conversely, the regression without other ODA may lead to overestimation, because then it can include part of the impact of this variable (as a selection effect).

Because of potential reverse causality (budget support leads not only to more education and health care, but countries also receive budget support because they are tackling problems in these sectors), we also show results from *two stage least squares* (2SLS) estimates, in which we instrumented for budget support (and other ODA, see annex V).

It turns out to be difficult to determine impact at this level. The number of observations is limited (varying from 71 to 101 countries) and there is great heterogeneity. In addition, general budget support was only one of several foreign aid instruments. These other instruments played an important role, especially in health care. A positive impact is especially demonstrable in education, but barely so in health care.

The impact in education was especially apparent in enrolment and the increase of the number of teachers in primary schools. Improving these indicators is a high priority for donors. It is telling that budget support did not have a significant impact on girls' enrolment in education (as opposed to better overall enrolment in education). It is also telling that after instrumenting, budget support did not have a significant impact if debt relief (which prescribed the PRSPs) was included as a control variable. In short, it is difficult to separate the various impacts.

In health care, budget support only displays a significant impact with professional care during childbirth. That is also the case for vaccination if HIPC and other ODA are left out of the analysis. However, precisely the large funds in health care (like the Global Fund) have exerted great influence on vaccination programmes. Budget support, incidentally, did make coordination easier for the Ministry of Health.

Table 7.10: Relationship between budget support and a number of social indicators (changes between 2000 and 2010)

	Excluding other ODA		Including other ODA	
	t- value	significance	t-value	significance
OLS:				
Education				
Number of teachers primary education	2.48	**	2.42	**
Number of teachers secondary education	2.75	***	1.85	*
Trained teachers primary education (%)	2.11	**	1.81	*
Enrolment primary education	4.22	***	3.68	***
Enrolment secondary education	0.26		-0.86	
Enrolment girls (primary)	1.99	**	0.12	
Enrolment girls (secondary)	0.41		-0.10	
Health care				
Nurse and midwives (per 1,000)	0.34		0.35	
Number of doctors	0.22		0.66	
Professional care at childbirth	3.23	***	2.19	**
Children treated for diarrhoea	-0.79		-0.89	
Vaccinated children*	2.67	***	-0.36	
2SLS:				
Education				
Number of teachers primary education *	3.29	***	1.17	
Number of teachers secondary education	3.03	***	2.47	**
Trained teachers primary education (%)	2.60	**	2.85	***
Enrolment primary education *	3.20	***	0.54	
Enrolment secondary education	0.38		-0.77	
Enrolment girls (primary)	1.29		0.27	
Enrolment girls (secondary)	0.35		0.54	
Health care				
Nurse and midwives (per 1,000)	-0.04		0.10	
Number of doctors	0.17		0.58	
Professional care at childbirth	2.34	**	1.98	**
Children treated for diarrhoea	0.22		0.18	
Vaccinated children *	2.95	***	0.91	

*Significance levels: *<10%; **<5%; ***<1% (based on robust standard errors).*

** The variant that excludes other ODA also excludes debt relief (HIPC).*

7.4.2 Results in six case study countries

In *Ghana*, the number of public schools increased by 5% and the number of teachers by 8% between 2000 and 2005. Partly as a result of this, and because school fees had been abolished, enrolment in education increased by almost 20%. Moreover, the number of girls attending school increased in particular, which improved the ratio of girls to boys from 0.90:1 to 0.95:1. The abolition of school fees was made possible by government contributions to the schools from budget support. At the time, there was barely any improvement visible in health care mainly because no solution had been found for the fact that the poorest people had to make personal health care contributions. There was still no national health care system, which the consultants viewed as a failure of the policy dialogue (Lawson et al. 2008). Three years later, IEG also concluded that, despite all the improvements, results often failed to meet expectations, including in Ghana.

In *Tanzania*, the government used a large part of extra tax revenue, as a result of economic growth, to improve services in the social sectors (Mkenda, Luvanda and Ruhinduka 2010). Only limited new employment resulted from this, and therefore economic growth did not lead to a strong decline in poverty, according to the researchers. Investment did help reduce other forms of deprivation, however, and generate improvements in a number of the MDG targets. Today, almost 90% of the children are vaccinated against diphtheria, whooping cough and tetanus, and cases of malaria are strongly declining as well. This was partly responsible for reducing child mortality by 40%. The prevalence of HIV also decreased strongly (Lawson et al. 2010).

In *Zambia*, additional resources for the social sectors led to an extension of a number of basic services. The number of employees in the health care sector increased from 12,000 in 2005 to more than 17,000 in 2010. In that same period, the availability of the most essential medicines also improved, from 71% to 82%, and the vaccination of children in the least accessible districts from 63% to 69%. Tuberculosis, malaria, diarrhoea and child and mother mortality decreased significantly, in part thanks to this policy. The number of teachers in primary education rose from 50,000 to 63,000, and the number of classrooms from 33,000 to 44,000. The investments helped to increase school enrolment from 2.9 million to 3.4 million pupils. Today, 52% of pupils complete the nine years of basic education, as opposed to 43% in 2005. The statistical analyses of the impact of government expenditures show that higher government investments are mainly responsible for these improvements.

Lawson et al. (2011) concluded for *Mali* that the extension of a number of services would not have been possible without general and sector budget support. Higher enrolment in primary education made it necessary to train more teachers, which was made financially possible by general budget support and sector budget support. The number of local health care centres increased from just over 600 in 2002 to almost 1,000 in 2009.

Infant and child mortality in *Vietnam* decreased, and access to water, sanitation and electricity improved. The improvements in the health care and water and sanitation sectors, however, could not be attributed to the policy dialogues in these sectors, because they

were not very effective. The spectacular rise in enrolment in primary and lower secondary education (enrolment improved from 72% in 2002 to 95% in 2005) is partly a result of budget support (PRSCs), through higher expenditures on education, the coordinated support of the 'Education for All' initiative and programmes to improve the quality of education (Grawe 2010).

Debt relief and conditionality led to more expenditures on poverty reduction measures in Nicaragua, but the impact of this spending on the social indicators was disappointing. They had improved from 1993 onwards, but ironically they stagnated in the period that the country received general budget support. Infant and child mortality only gradually decreased, and there was barely any improvement in access to primary education. More recent government figures show improvement, but it is not clear how reliable these figures are.

7.5 Distribution

When discussing the extension of services, in the framework of budget support, it is also important to ask who is benefiting from these services. The answer to that question initially depends on policy carried out by the government. In various countries, governments attempted to make expenditures in the health care sector more 'pro poor', among other things by abolishing personal contributions in health care (Armenia and Ghana), free health care for the poorest (Vietnam), minimum services for the poorest (Benin, Laos) and waiving of tuition (e.g. Ghana, Tanzania and Mozambique) (IEG 2010, pp. 79-80). In Uganda, the government used funds from the Poverty Action Fund to finance high-priority programmes aimed at fighting poverty (IDD and Associates 2006). This was less the case in other countries. Rwanda had a broad development strategy, but the different programmes did not address poverty reduction systematically. Something similar happened in Mozambique, where the government and donors had more of an eye for strengthening the budgetary system than for shifting expenditures more in the direction of poverty reduction. Burkina Faso financed an important part of its expenditures on fighting poverty with HIPC debt relief. The budget support focused less on that (IDD and Associates 2006, pp. 44-46). The Bolaños government in Nicaragua showed little concern for improving services for the poorest (Dijkstra and Grigsby, 2010).

IEG concluded that Performance Assessment Frameworks were only aimed to a limited degree at poverty reduction or helping the poorest: as little as two-fifths of the PRSC objectives in education focused on poverty; this was a half for health care, and less than a fifth for water and sanitation (IEG 2010, p. xvii). Programmes focused mainly on budgetary aspects, with an emphasis on increasing resources and improving efficiency. There was insufficient coherence with projects in the sector, however.

According to IEG (2010), poverty reduction policies were not always effective. They did lead to better access to public services for the poor in some countries (e.g. Benin, Mozambique and Vietnam). But this was not so much the case in other countries (such as Armenia and Nicaragua). Debt relief and conditionality caused expenditures on poverty reduction measures to increase in Nicaragua between 2002 and 2005, but their impact on social indicators was disappointing. A major problem was that much of what was registered as social expenditures or even expenditures to fight poverty never actually reached the poor. But even in the most successful countries (such as Mozambique and Vietnam), it turned out to be difficult to reach the poorest groups (IEG 2010, p. 79).

Other evaluations often devote little attention to distribution factors. Most studies usually conclude that urban and rural differences continue to exist. The *Tanzania* evaluation is an example. It concluded that although health care services had significantly expanded, people in rural areas had trouble accessing and using them (Lawson et al. 2010, p. 11). Most services were to be found in urban areas. Costs were also an obstacle to using health care services in Tanzania. In addition, staff shortages continued to prevent improvements from taking hold in the health care sector.

One problem with many evaluations, however, is that they do not make an analysis through time. The question is not so much whether differences between rich and poor or between city and country still exist, but more whether these differences are shrinking. The *Zambia* evaluation concluded that inequalities in the access to public services were gradually declining. The abolition of school fees and extending services led primarily to higher school enrolment in the poorest groups. In rural areas, the number of pupils per teacher barely decreased, but that was mainly a consequence of strong growth in school enrolment in these areas: new teachers made it possible for new pupils to enrol and encouraged it. A number of figures improved in health care for poorer, more rural areas. The impacts were more limited in other areas, such as good drinking water in rural regions. Good drinking water is extremely important, but the Zambian government invested little in this. It was mainly donor projects that had to generate improvement.

Tables 7.11 and 7.12 show positive distribution effects for education and health care.

Table 7.11: Enrolment in primary education in Zambia, Tanzania and Ghana by income (2000–2010)

		Poorest 20%	Second quintile (20%)	Middle 20%	Fourth quintile (20%)	Wealthiest 20%
Zambia	2000	51%	58%	65%	73%	87%
	2007	73%	74%	80%	85%	90%
Tanzania	2005	58%	66%	73%	82%	88%
	2010	68%	74%	83%	86%	90%
Ghana	2004	43%	56%	64%	68%	78%
	2010	59%	72%	77%	82%	86%

Source: IOB 2011; DHS Tanzania; DHS Ghana.

Table 7.12: Financial impediments for access to health care services in Tanzania and Ghana by income (2004–2010)

		Poorest 20%	Second quintile (20%)	Middle 20%	Fourth quintile (20%)	Wealthiest 20%
Tanzania	2005	51%	49%	44%	40%	23%
	2010	42%	31%	26%	19%	10%
Ghana	2004	74%	68%	60%	51%	33%
	2010	60%	50%	49%	41%	31%

Source: DHS Tanzania; DHS Ghana.

7.6 Conclusions

The theory of change on the impact of budget support on poverty reduction is rudimentary, and donors have barely made an attempt to focus on the impact of budget support on poverty. It was not clear what donors wanted to achieve in what time span using which resources.

This lack of a well-developed theory is part of the reason why the effects of poverty have received limited attention in evaluations of budget support. Indeed, even more so than with the relation between budget support and economic growth, evaluations of budget support assume what the effects of poverty are instead of actually analysing them. Various studies went no further than to state that since poverty had declined in a given country there must be a link between the two. Available research does often point out that expectations were unrealistic. In many countries, especially in Africa, economic growth did not take place in sectors where one would expect major effects of poverty. Especially in rural areas poverty is a persistent phenomenon. The rural population depends on the development of

agriculture, and this sector has lagged behind the growth sectors in many countries. As a result of this, the growth elasticity of poverty is low.

Various comparative studies nonetheless suggest that there is a positive correlation between budget support and poverty reduction: poverty declined more *on average* in countries with budget support than countries without or with little budget support. The same is true of the UN development index, which correlates strongly with poverty indices that focus mainly on income or consumption: countries with budget support also climbed higher on this index than countries with little or no budget support, even after checking for economic growth, good governance and debt relief.

Nevertheless, the conclusion of the different case studies is that budget support did not have a major impact on income poverty or poverty in general. Nor were those policies always effective and not sufficiently focused on reducing rural poverty. Ghana and Vietnam are the most significant exceptions to this. The most important reason why the results are disappointing, however, is that there were such unrealistic expectations of what the instrument could accomplish in a short time. These unrealistic expectations suggest that the policy theory is not very elaborate.

The latter does not necessarily mean that little has been achieved for the poorest, especially rural, population groups. Various evaluations conclude that general budget support was effective in helping to increase spending on public services, particularly in education and health care. There seems to be a leverage effect at times: the increase in spending is greater than may be expected based on financial transfer alone, which dovetails with the findings in this study, which suggests that the impact of spending on both sectors are commensurate with the size of the budget support. Indeed, expenditures on both sectors increased more in countries that received budget support than in comparable countries that did not use, or barely used, these kinds of resources.

One important condition for such a spending increase is ownership on the recipient end. Public pressure to improve services in these sectors, as well as pressure by employees in these sectors to do something about their salaries, turns out to be an effective condition to guarantee that budget support will also be used in the sectors that the donors intended it for. In that sense, alignment of donor and recipient government preferences is of paramount importance for the effectiveness of budget support. Without this alignment, budget support will be spent on the wrong sectors or the wrong type of expenditures, despite all the agreements in the Performance Assessment Frameworks. Project aid is more effective in such cases, despite fungibility problems.

Evaluations show that additional resources led to an extension of public services and their use. Although the positive impact on the social sectors was generally insufficiently researched and the reported positive impact insufficiently substantiated, almost all studies pointed in the same direction. They show that countries with substantial budget support made more progress in a number of MDG indicators compared to similar countries that received little or no budget support. The question, of course, is which groups profited most from this. Various evaluations tend to get stuck in a static analysis, which observes that differences between city and country are still far too large and that the poorest segment of the population is still barely being reached. A more dynamic analysis, which focuses on development, often shows greater improvements, even if change is slow in coming. The clearest example is access to primary education.

The effectiveness of a policy that concentrates on the poorest part of the population does require the government to have a strong poverty focus, as well as a holistic approach, which views local (i.e. rural) problems in context. Donors can attempt to 'keep tabs' on governments, but that is about the extent of their reach. Here too, it is true that if the recipient government does not have a clear will and commitment to tackle poverty problems in its own country, the policy will be ineffective. Conditionalities will do little to change this.

Despite all the positive findings, the results in terms of improved public services also fail to meet the expectations. There are two reasons for this. First, many of the expectations were unrealistically high in light of the available resources. A second reason is that budget support went hand in hand with the neglect of implementation capacity. Donors and their Performance Assessment Frameworks focused both on improvement in the MDG indicators and improvements of central processes (such as PFM), but barely on bottlenecks in implementation. Governments and donors were especially keen on investments in 'hardware', but too little on local 'software', i.e. local management burdened with the actual implementation. That is where problems of quality persist most stubbornly. If donors want to enhance the effectiveness of budget support, they are going to have to devote more attention to this.

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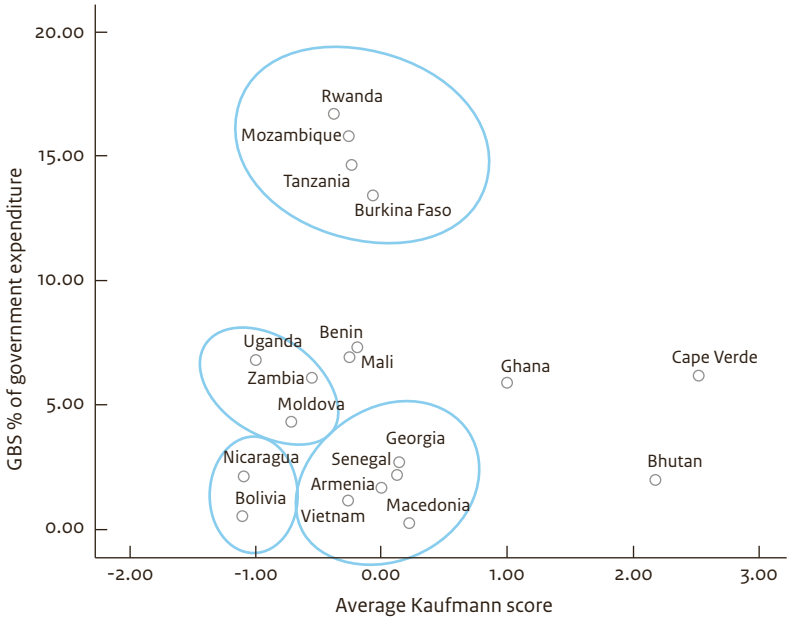
Annexes

Annex I: Selection of case studies

IOB selected 11 candidates for the case studies, based on financial and political importance (in the Dutch discussion). They were Burkina Faso, Burundi, Ghana, Mali, Mozambique, Nicaragua, Rwanda, Tanzania, Vietnam, Uganda and Zambia.

Taking these 11 countries as a starting point, the team narrowed down this selection based on variation in governance and the significance of GBS for the government budget. The analysis is based on average figures for the years 2004–2010. This resulted in the following picture:

Figure I.1: *Relative significance of general budget support and governance scores (2004–2010)*



The x-axis shows the average score on the four Kaufmann indicators for the years 2004–2010. In this figure, Ghana, for example, deviates strongly from other countries, while Tanzania (or Benin or Mali), for example, are close to each other.[92]

[92] Burundi was not included in the figure because the country scored much worse on the Kaufmann indicators, which puts the other countries extremely close to each other.

Table I.1 shows how the 11 countries are clustered together.

Table I.1: Classification of 11 countries by good governance and financial significance of GBS

Governance*	GBS/Government expenditure or revenue**		
	High	Average	Low
Good		Ghana	
Average	Mozambique, Tanzania, Burkina Faso	Mali	Vietnam
Bad	Burundi, Rwanda	Uganda, Zambia	Nicaragua

* *Governance: Bad: <-2.20; Good: >-1.20*

** *GBS/Expenditure and GBS/Revenue: Low: <5%, High: >8%*

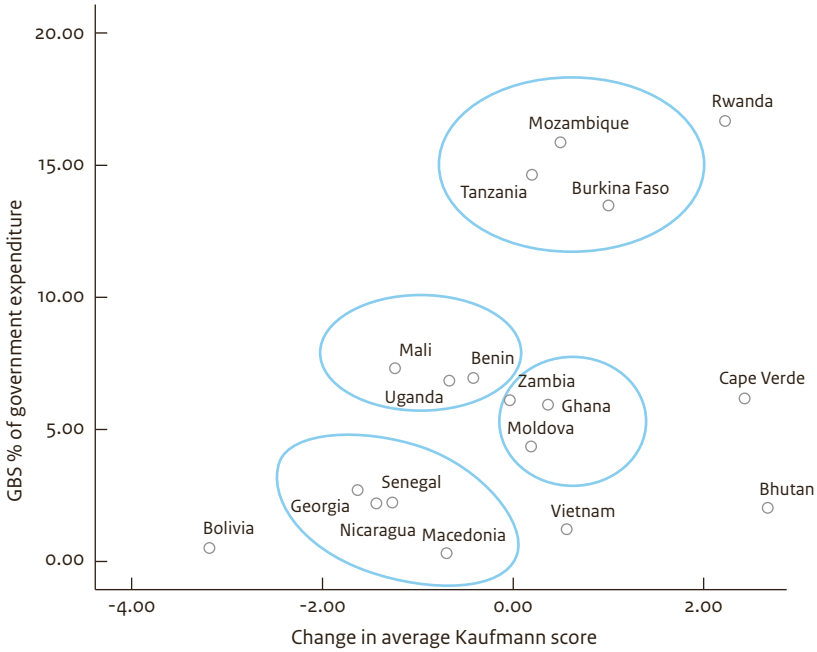
Ghana stands out in terms of governance. Uganda and Zambia are close to each other, so it seemed obvious to only include one of them in the analysis, in light of having a selection with the greatest differences (on these two variables). IOB chose Zambia because it had recently done an evaluation of budget support to that country.

Mozambique, Tanzania and – to a lesser degree – Burkina Faso are all relatively strongly dependent on budget support and have similar Kaufmann scores. Of these countries, Tanzania was – until recently – the main recipient of Dutch budget support. Mali has an average score on both variables, but was initially, in 2011, the only country that the Netherlands wanted to continue giving general budget support to after 2013.

Vietnam has strongly improved its scores on the various Kaufmann indicators in recent years (see also figure I.2). The country received relatively little budget support. Nicaragua has a combination of low scores on the Kaufmann indicators and a relatively low amount of general budget support.

Nicaragua and Vietnam *seem* somewhat equal in terms of average governance indicators, but they clearly differ if one looks at the development on these indicators (see figure I.2). Moreover, these two countries represent different regions.

Figure I.2: *Relative significance of general budget support and change in governance scores*



Burundi and Rwanda did not directly receive GBS from the Netherlands (Burundi only received it via the World Bank, and Rwanda only received sector budget support). In addition, the aid given to Burundi was not really general budget support but rather stability support. The ultimate selection (Tanzania, Ghana, Mali, Zambia, Nicaragua and Vietnam) is well balanced regionally: 2x West Africa, 2x Southern Africa, 1x Asia and 1x Central America.

Annex II: Partner countries from 1999 onwards

Minister Herfkens:

17+4 Partner countries:	Bangladesh, Bolivia, Burkina Faso, Eritrea, Ethiopia, Ghana, India, Macedonia, Mali, Mozambique, Nicaragua, Sri Lanka, Tanzania, Uganda, Vietnam, Yemen and Zambia; Egypt, Indonesia, the Palestinian Territories and South Africa.
15 GHP countries:	Albania, Armenia, Bosnia and Herzegovina, Cambodia, Colombia, El Salvador, Georgia, Guatemala, Guinea-Bissau, Honduras, Kenya, Moldova, Namibia, Nepal and Rwanda.
8 Environmental countries:	Brazil, Cape Verde, China, Ecuador, the Philippines, Mongolia, Peru and Senegal.
5x Business sector:	Côte d'Ivoire, Cuba, Jordan, Nigeria and Thailand.

Minister Van Ardenne:

36 Partner countries	Afghanistan, Albania, Armenia, Bangladesh, Benin, Bolivia, Bosnia and Herzegovina, Burkina Faso, Cape Verde, Colombia, Egypt, Eritrea, Ethiopia, Georgia, Ghana, Guatemala, Indonesia, Kenya, Macedonia, Mali, Moldova, Mongolia, Mozambique, Nicaragua, Pakistan, the Palestinian Territories, Rwanda, Senegal, South Africa, Sri Lanka, Suriname, Tanzania, Uganda, Vietnam, Yemen and Zambia.

Minister Koenders:

18 MDG countries	Benin, Bangladesh, Bolivia, Burkina Faso, Ethiopia, Ghana, Kenya, Mali, Moldova, Mongolia, Mozambique, Nicaragua, Rwanda, Senegal, Tanzania, Uganda, Yemen and Zambia
9 Fragile states	Afghanistan, Burundi, Colombia, Congo (DCR), Guatemala, Kosovo, Pakistan, the Palestinian Territories and Sudan
4 Emerging countries	Egypt, Georgia, Suriname and Vietnam

Minister Knapen:

6 MDG countries	Benin, Ethiopia, Mali, Mozambique, Uganda, Rwanda
5 Fragile states	Afghanistan, Burundi, the Palestinian Territories, Sudan and Yemen
4 Emerging countries	Bangladesh, Ghana, Indonesia, Kenya,

Annex III: Budget support expenditure 1999–2011

Table III.1: Budget support expenditure 1999–2011 (amounts × EUR 1 million)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Armenia	5	5	5	5	5	5	5	5	2				
Bangladesh													
Benin					3		2	10	10	10	10	8	
Bhutan										2	2	2	2
Bolivia	5	1	16	10	13	7	1						
Burkina Faso			18	13	10	19	15	18	19	20	21	18	21
Burundi								8	11	15		9	
Cape Verde	2					5	2	3	8	7			
Colombia													
Georgia	4			7		3	4	5	3	3	3	2	
Ghana	7	7	87	9	7	17	10	15	25	24	25	20	10
India				25									
Indonesia													
Kenya													
Kyrgyzstan	1	1	1		1								
Macedonia	9	17	28		17	9	13			7	7		
Mali	5	27	9	10	8	10	10	10	10	12	12	13	15
Moldova		11	11					3	4	4		3	
Mozambique	5	26	51	15	20	18	16	16	18	18	18	18	18
Nicaragua		7		8	7	7	9	10	11	6			
Palestinian Territories							5						
Rwanda													
Senegal										10	10	3	
South Africa													
Sri Lanka													
Suriname													
Tanzania		59	16	15	25	15	10	30	30	30			
Uganda	9	30	10	8	10	22	16	16	21	5			
Vietnam			6	10	8	8	8	24	12	6			
Yemen	7	8											
Zambia								6	8	10	10	10	
Total	**57**	**199**	**257**	**131**	**135**	**144**	**125**	**178**	**190**	**188**	**117**	**106**	**66**

Table III.1: Budget support expenditure 1999–2011 (amounts × EUR 1 million)													
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
GBS structural	20	33	42	59	83	92	90	133	159	154	108	92	66
Co-financing	25	30	64	60	42	27	35	42	31	34	10	14	
GBS incidental		98	133		3	18		3					
Social funds	12	38	18	12	7	7							
Total	**57**	**199**	**257**	**131**	**135**	**144**	**125**	**178**	**190**	**188**	**117**	**106**	**66**

Source: Midas/Pyramid

Annex IV: Budget support and Kaufmann indicators

Figure IV.1: *Voice and accountability*

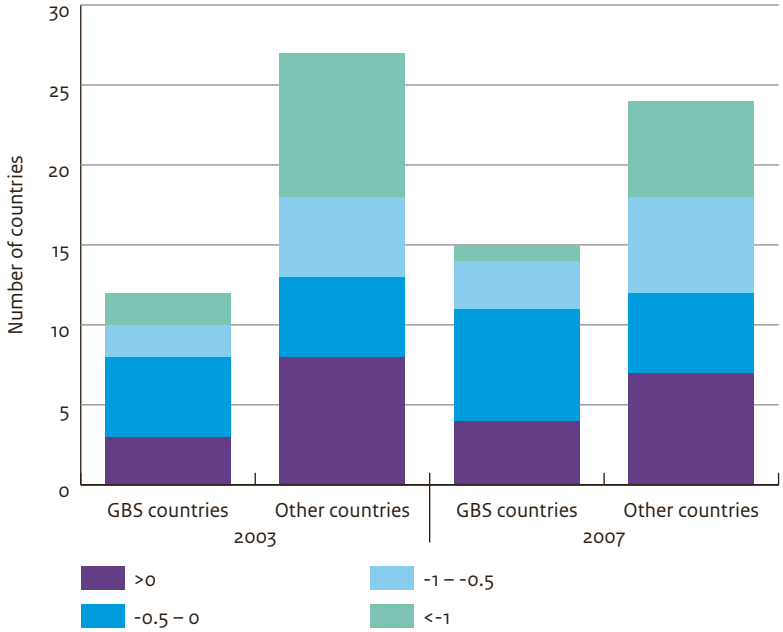


Figure IV.2: *Political stability*

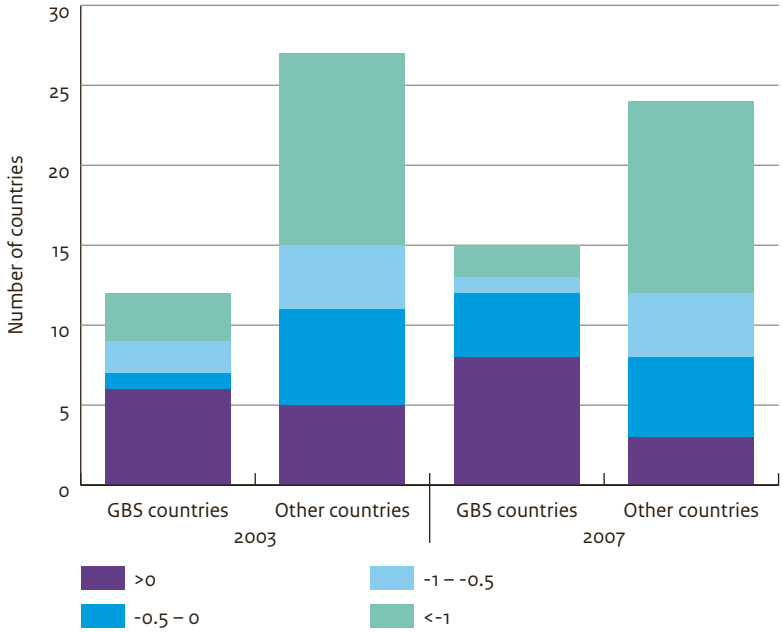


Figure IV.3: *Government effectiveness*

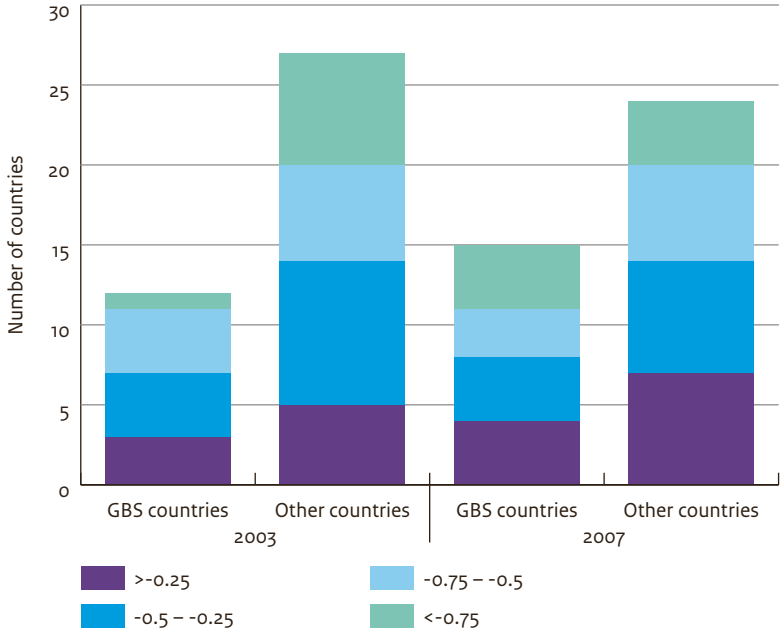


Figure IV.4: *Regulatory quality*

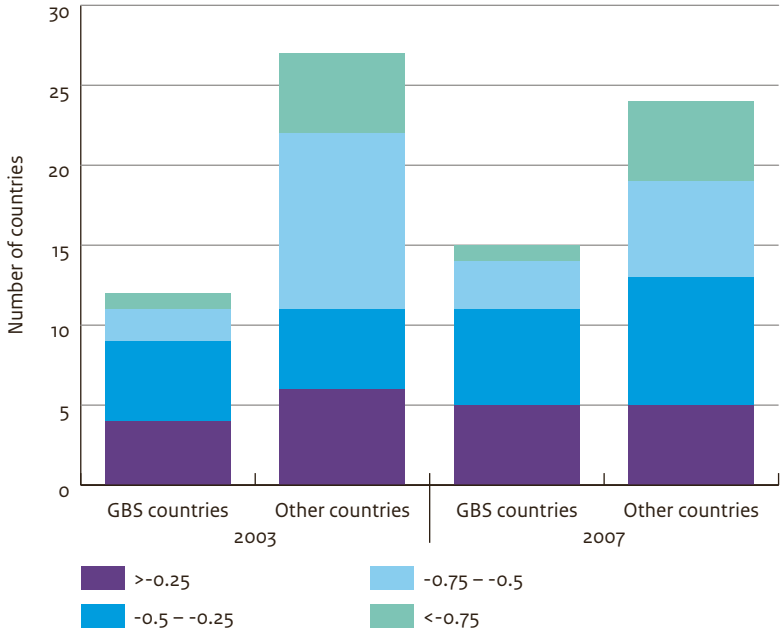


Figure IV.5: *Rule of law*

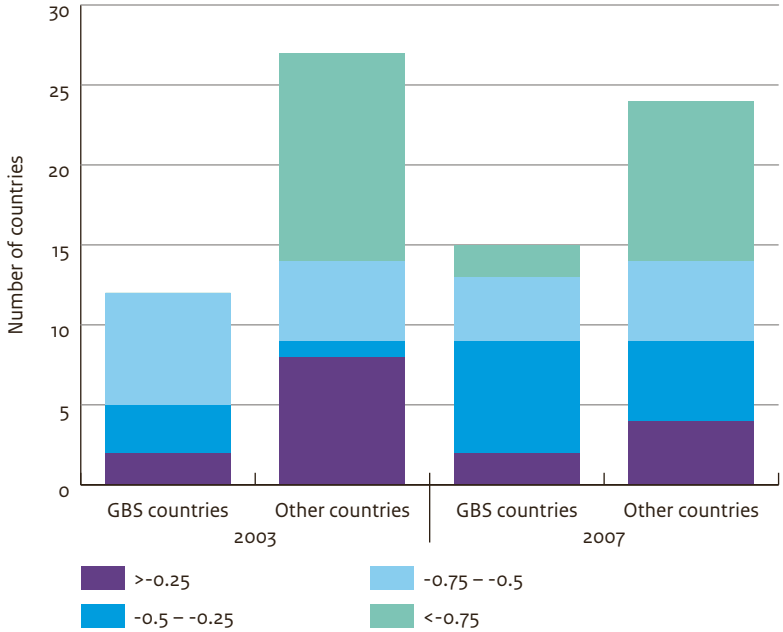
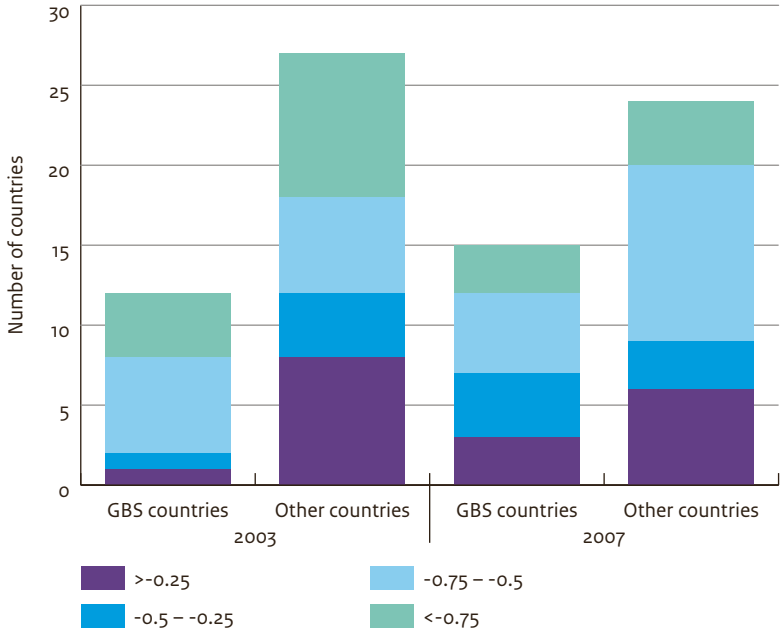


Figure IV.6: *Control of corruption*



Annex V: Bottlenecks in international comparative research

1. Introduction

This annex briefly deals with several techniques that we used in our research. The following section serves as a short introduction to the problems of measuring the impact of aid and the solutions for this. The rest of the annex is more technical and serves mainly as a justification of the research.

2. Bottlenecks in international cross-country research

One reason why studies show diverging results is the correlation between potentially explanatory variables (including control variables). Various studies suggest that tropical climates have a negative impact, while other studies examine the colonial background as an explanation for low economic growth or a limited impact of development cooperation. According to others, aid is only effective in a favourable macro-economic policy environment. All these factors are strongly correlated, or, to put it more accurately, were in the past. As a result, all these studies largely measured the same phenomena: aid had less impact in many African countries situated in the tropics or in countries where European colonists had in one way or another settled than was the case in the United States or Australia, for example, where other types of institutions were set up.

A problem with some of the studies is the high correlation between the explanatory variables incorporated into the models, or the problem of multicollinearity: an explanatory variable can be almost entirely predicted from other explanatory variables. In that case, the estimated coefficients not only reveal high uncertainly margins, but the reliability decreases strongly as well, whereby a variable can even get the wrong sign (see also Roodman 2008; Clemens and Bazzi 2009). An example is the quadratic term (aid × aid) in various studies that should show that there are diminishing returns. This quadratic term is negative in almost all studies.

In the practice of econometric research, it turns out to be difficult to establish a significant positive correlation between development aid and economic growth. Mosley (1987) called this the *micro-macro paradox*: while many evaluations of individual projects pointed to the positive impact of development aid, this impact was barely discernible in a comparison between countries.

The main problem behind the paradox of Mosley is also methodological. Not only is development aid expected to have a positive impact on the economy, but, conversely, it is also determined by stagnating development: aid does not only contribute to economic growth, but it is provided *because* countries are poor. The latter means that the correlation in the short term is not positive but negative (see also Roodman 2008; Clemens and Bazzi 2009 and Dalgaard and Hansen 2010). Neglecting this reverse causality may result in the impact of aid being underestimated. Other factors, such as a disaster, can have an impact on both aid

and on economic growth, as a result of which it is not clear either to what extent economic growth is being influenced by aid or whether both variables are being influenced by a third (unobserved) variable.

This is an equally prominent problem, perhaps even more so, with general budget support. For example, countries can be eligible for budget support *because* they already have good macro-economic policy. Neglecting this relationship can potentially result in the impact of budget support on economic development being overestimated.[93] Good policy will not only contribute to stronger economic growth, but it can also result in donors being prepared to provide more aid. The absence of a policy variable in the model can lead to the impact of aid being overestimated if countries with poor policy receive little aid and countries with good policy receive more. An additional problem with general budget support is its relatively short time span, leading to short time series.

There are different techniques for dealing with the above-mentioned *endogeneity problems*.[94] A first approach is to include *control variables* in the model that can potentially distort a correct estimate. Economic policy is an example.

There are two problems that prevent this solution from always being applicable. The first reason is that researchers may be aware of the influence of other variables, but cannot always measure them. The second reason has been dominating the debate on impact assessment: researchers often have insufficient information to determine whether a variable is *exogenous*. The measured relation with the dependent variable could be caused by *selection on unobservables*. We speak of a selection effect because there is no longer a guarantee that the control group and intervention group are equal to each other in terms of the key characteristics (such as economic policy).

There are solutions for these bottlenecks, which, it should be noted, can generate new problems. One approach, for example, is to shift the focus of the analysis from differences between countries to differences within countries.[95] Another technique is to use *instrumental variables*. If aid is endogenous, a solution to this problem may be the use of an estimate of the endogenous variable, based on another exogenous variable.[96] This technique may also solve the problem of reverse causality.

93 As was shown in chapter 4, there is no empirical evidence supporting this hypothesis.

94 Endogeneity means that an explanatory variable is not independent within the model, but that its value is determined by other variables in the model. An important cause of this is leaving out the variables that are both correlated with the intervention and the impact that is going to be measured. There is also endogeneity when the explanatory variable not only has an effect on the dependent variable but, conversely, when the dependent variable also has an effect on the value of the explanatory variable. In econometrics, an explanatory variable is said to be endogenous when it is correlated with the error term in an equation (see for instance Wooldridge (2002), Verbeek (2005) or for budget support Elbers et al. (2009).

95 For an explanation and concrete application of this, see Elbers, Gunning and De Hoop 2009.

96 For a detailed explanation, see Khandker et al. 2010, for example.

3. Instrumenting for aid

As indicated above, it is possible for estimates of the impact of budget support to be biased, because the amount of aid not only influences the partner country's policy, but, conversely, can be influenced by it as well. We use different techniques to correct for potential selection bias, such as incorporating a separate control variable for policy, as well as instrumenting for budget support. The latter means estimating the impact of budget support with the help of one or more other exogenous variables that could not have been influenced by the partner country's policy. For this, we use the two stage least squares (2SLS) method. In the first stage, we estimate the impact of budget support based on exogenous variables, and in the second stage we use this estimate to determine the impact of budget support.

For the instrumentation, we essentially follow Rajan and Subramanian (2005) and Arndt, Jones and Tarp (2010). They select aid per capita (aid/population) as the dependent variable. This is a function of:

1 colonial relations (past and present);
2 a common language;
3 the relation between the donor's population and the recipient country's population ($population_d/population_c$). The idea behind this is that larger the donor is in relation to the recipient, the higher the aid per capita;
4 interaction effects; and
5 fixed donor effects.

The $population_d/population_c$ ratio needs to justify the differences in size between donors. In addition, the researchers also incorporate fixed donor effects (with the help of dummy variables).

We opt for a slightly different approach, in which we view the *total* amount of aid of a donor as a given, whereas only the *distribution* is determined by specific characteristics. It is also justified to view this total amount of aid (for the recipient country) as exogenous, because it is mainly determined by domestic political considerations (think, for example, of the 0.7% discussions). Only the actual distribution is not exogenous. The latter means that we only have to instrument for the distribution. Keeping in mind the *regional character* of a large portion of aid, we go a step further and also consider the regional distribution per donor as given. Regional preferences are mainly an expression of historical ties and regional policy. Australia provides aid primarily to Asia and Oceania, while various European countries concentrate on Europe and Africa. The United States donates a relatively large amount to Latin America. Regional banks are only active in a specific region.

The *amount* that a recipient country *c* receives in regional aid *r* from donor *d* is then a function of a number of characteristics, including population size, past and present colonial relations and the existence of a common language. This is how we estimate the amount of aid from the donor (d) to the recipient country (r) in year t:

$Aid_{dct}/Aid_{drt} = f\,(X\ldots\ldots\ldots\ldots)$.

In doing so, we use OECD/DAC's division into nine regions.
The amount to be estimated is a function of:

1 *Colonial ties* between donor and recipient. Unlike Arndt et al., we do not distinguish between past and present colonial relations. This is also related to the short time span (2002–2010) in our analysis.
2 *A 'common' language*. We included the official languages of the recipient countries, and based on that we then determined the donors' *language preferences*. We examined which linguistic regions the donors were active in. For the United Kingdom, for example, it is mainly the Anglo-Saxon linguistic region, while for France and Belgium it is much more the French-speaking countries in Africa. The explanatory variable here is the amount of the donor's aid in the dominant, international language in the partner country. For Tanzania, for example, it is English, and so Tanzania stands to receive more aid from a country that provides aid mainly to Anglo-Saxon linguistic regions (including the United Kingdom, but also various Scandinavian countries), than from countries such as France, Spain or Portugal.
3 *The income per capita of the population in 2000*. Strictly speaking, this is not an exogenous variable, but on the other hand, this is one of the principal allocation criteria.[97] There are other arguments to include this variable anyway:
   a Our analysis focuses on the period 2002–2010. These are years during which many developing countries did have high economic growth, which means that the presumed negative correlation between aid and economic growth is much lower than in the past.
   b Our analysis focuses on other factors than economic growth.
4 The portion of the population in the regional population in the recipient country. The larger the country, the larger the total amount of aid is expected to be. We also incorporate a quadratic term for this purpose.
5 We also include the latter variable (including the quadratic term) separately for Africa due to the large amount of development aid that went to Africa.

The regional concentration of development aid also has consequences for the approach. Donors are not active in all development countries, but often only in a smaller number of countries. The amount of development aid given to a country depends on the outcome of two processes:
a the choice to provide aid to a country (cf. the Dutch partner countries), and
b decisions about the amount of aid.
This means that we cannot directly estimate the amount of aid, but that we estimate it with the help of a Heckman two-step procedure. In the first step, we estimate the probability that a country will receive development aid (with the help of a probit model). In the second step, we estimate the amount of aid, making use of estimates from the first step.

[97] Other researchers implicitly include an income variable as well, because they only incorporate aid to developing countries or countries that receive ODA in their model. Others use lagged variables for instrumentation, which we do here as well.

For the first step, which renders the *probability* that a potential recipient will receive development aid from a specific donor (in a given year), we mainly use the same variables, with the following modifications:

a *the donor's population size:* this is important because the probability that a country received aid from a specific donor is higher if the donor is bigger (cf. the United States or the European Union);

b *the interaction effect of the regional share of the donor's total aid in terms of percentage (in that year) and the donor's population size:* The higher this percentage and the bigger the donor is, the greater the probability that a specific country will also receive aid from this donor;

c *the interaction effect of this regional percentage and the inverse of the GPD per capita of the population of the potential recipient:* the more the region receives and the poorer the country is, the higher the probability of receiving aid.

We excluded the following types of aid: budget support (instrumented separately, see next section), debt relief (which often concerned administrative transactions) and humanitarian aid. Donor dummy variables are not shown. The analysis is based on the years 2002–2010.

Table V.1: Instrumentation of aid, excluding budget support*				
	Coefficient	Standard error	Z score	Significance
English	0.106	0.005	21.27	***
French	0.093	0.009	10.53	***
Spanish	-0.008	0.023	-0.33	
Portuguese	0.291	0.026	11.03	***
Dutch	1.149	0.071	16.22	***
Log (population)	-0.101	0.003	-37.77	***
Colonial ties × log (population)	0.007	0.001	10.54	***
Log (GDP pc 2000)	-0.073	0.003	-26.95	***
Log (population/regional population)	0.412	0.010	39.54	***
Log (population/regional population)^2	0.035	0.002	21.41	***
Africa × log (population/regional population)	0.089	0.004	22.87	***
Africa × log (population/regional population)^2	0.018	0.001	17.17	***
Constant	1.945	0.031	62.19	***
Countries receiving aid from donors:				
English	0.754	0.058	13.04	***
French	0.950	0.108	8.8	***
Spanish	8.227	0.384	21.41	***
Portuguese	2.241	0.535	4.19	***
Dutch	7.830	2.779	2.82	***
Colonial ties	0.336	0.090	3.72	***
Log (population)	0.636	0.017	37.27	***
Log population donor	1.583	0.092	17.14	***
Regional % aid × log (population donor)	0.001	0.000	15.11	***
Log (GDP pc 2000)	-0.485	0.026	-18.69	***
Regional % aid/log (GDP pc 2000)	0.705	0.058	12.11	***
Constant	-15.299	0.802	-19.07	***
Mills Lambda	0.086	0.003	25.77	***
N=30.380				
Wald Chi^2=13.492				

*Significance levels: *=p<10%; **=p<5%; ***=p<1% (based on robust standard errors).*

* *And excluding debt relief and humanitarian aid. The dependent variable is the amount of donor aid (d) to the recipient (c) in year t. Data for 2002–2010.*

4. Instrumenting for general budget support

In order to instrument for general budget support, we use a slightly different approach, which is somewhat closer to the choices of Rajan and Subramanian and Arndt et al. On the one hand, we take the budget support per capita of the population as our starting point for the dependent variable. In addition, we also take the regional distribution (across nine regions) as a given.

The question whether and to what degree a country (of a specific donor) receives general budget support depends partly on a number of other factors:

1 The provision of general budget support is almost always a next step in an aid relationship that has already existed for some time. We operationalize this as the average amount of *commitments* in the *previous* two to four years (again, exclusively debt relief and humanitarian aid).[98] We take the amount of these commitments of the regional total as explanatory variable. This variable is incorporated into the interaction with the total GBS of the donor to the region (per capita of the population).
2 In Asia, this relative amount is small due to the presence of two extremely large countries (China and India) that received aid. For this reason, we included this impact separately as well for Asia. If we did not, that would lead to very limited budget support to other Asian countries in our chosen approach.
3 Whether a country receives budget support from a specific donor also depends on the amount of budget support in the donor's total ODA. In addition, HIPC countries in particular have received budget support. We incorporated this as an interaction of HIPC countries with the amount of GBS in the total aid flows of the donor and the total commitments to the recipient country in relation to the total regional commitments. The probability of receiving budget support from a specific donor is therefore great if a country has received debt relief from the HIPC initiative, if the donor uses a large part of its ODA as budget support (such as the United Kingdom or the EC) and if the country's share of the total regional ODA is great.
4 Furthermore, countries with good governance would be the primary recipients of budget support. Good governance, however, is not a sufficient condition. It concerns mainly low-income countries with relatively good governance. We operationalized this as the Kaufmann score two years earlier in interaction with the inverse of the income per capita for 2000.
5 In practice, political stability is an important condition for budget support. In order to do this justice, we incorporated this variable in the model in interaction with the donor's regional GBS per capita.

[98] Strictly speaking, this variable is not exogenous because past commitments are correlated with present aid flows. In practice, this is not a serious problem with the proposed instrumentation. First, we used a lag of 2–4 years; second it concerns commitments and not actual aid (and there is a big difference between the two); third, we only incorporate this variable in interaction with other variables; and fourth, we also incorporate other aid into our model, so that we can control for that as well. Finally, various critics suggest that aid is not effective. They will not object, then, to incorporating a variable that in their opinion has no impact.

6 Countries that export large amounts of oil, such as Nigeria and Angola, receive little, if any, budget support. The export of oil two to four years prior to budget support is incorporated as a proxy for this.
7 Finally, the first estimates yielded very high results for countries in South-western Africa (such as Namibia, Botswana and South Africa). To correct this, we incorporated a separate dummy, as well as this dummy in interaction with these countries' population sizes.
8 In order to do justice to specific donor characteristics, we incorporated the following variables:
   a Specific donor dummy variables for the probability of providing budget support. Some countries, after all, provided much more budget support than other countries.
   b To determine the amount of budget support we included the interaction effect of these dummies and past commitments (see above).
   c An interaction effect for the relative amount of the donor's budget support (in relation to its total aid) and past commitments.
   d The relation between the size of the donor and the size of the partner country, as reflected in the logarithm of the population ratios (cf. the approach of Arndt et al).

The different variables are, when relevant, scaled to the same unit by division by the total population. Table V.2 shows the results, in which we have left out the first step the donor dummy variables.

Table V.2: Instrumentation of general budget support

	Coefficient	Standard error	Z-score	Significance
GBS per capita:				
English	1.12	0.59	1.89	*
French	-1.06	0.90	-1.18	
Spanish	-9.01	4.15	-2.17	**
Portuguese	1.70	1.72	0.99	
Dutch	2.65	4.13	0.64	
Relative commitments*	15.18	0.38	39.64	***
Relative commitments Asia*	26.56	3.68	7.23	***
Log (populationd /populationo)	0.87	0.18	4.76	***
Log (GDP pc 2000)	1.48	0.50	2.97	***
Oil export per capita (2–4 years earlier)	0.00	0.00	-3.15	***
Constant	-5.28	1.12	-4.70	***
Chances of receiving budget support:				
English	0.39	0.10	4.03	***
French	1.27	0.16	8.09	***
Spanish	2.89	0.50	5.73	***

Table V.2: Instrumentation of general budget support

	Coefficient	Standard error	Z-score	Significance
Portuguese	13.13	1.01	12.94	***
Dutch	4.28	0.76	5.60	***
Colonial ties	0.41	0.07	5.93	***
Log population	0.24	0.03	8.32	***
Log population donor	0.85	0.23	3.64	***
Log (GDP pc 2000)	-0.64	0.05	-11.60	***
HIPC × Amount GBS in total ODA donor × amount in regional commitments	9.27	0.48	19.47	***
Relative commitments*	0.74	0.09	8.46	***
Amount GBS in total ODA donor/log (GDP pc 2000)	5.61	1.05	5.35	***
Stability × regional budget support per capita	0.06	0.01	4.48	***
Kaufmann (t-2)/log (GDP pc 2000)	1.26	0.09	14.49	***
Oil export per capita (2–4 years earlier)	0.00	0.00	-1.99	**
Countries in south-western Africa	-0.59	0.10	-6.14	***
Countries in south-western Africa × log (population)	-0.07	0.01	-4.88	***
Constant	-8.89	1.93	-4.60	***
Mills Lambda	0.72	0.24	3.02	***
N=14.453				
Wald Chi^2=4.490				

*Significance levels: *=p<10%; **=p<5%; ***=p<1% (based on robust standard errors).*

* *Relative commitments= past commitments/past regional commitments × GBS donor per capita of the population to the region.*

Annex VI: Annex to chapter 7

Table VI.1: GBS ratios (2002-07) and change in MDG indicators (All aid recipients)

	GBS/ODA			
	L	M	H	Pearson
2.1: primary enrolment rate (% point) (1)	0.6	2.3	5.4	0.01
- average GBS ratio in each category (%)	0.0	1.1	9.0	ns
3.1: education gender disparity ratio (% point) (1)	0.8	2.4	4.4	0.30
- average GBS ratio in each category (%)	0.0	1.0	8.0	***
4.1: under 5 mortality rate (deaths/1000, + = reduction)	10.3	13.5	15.9	0.06
- average GBS ratio in each category (%)	0.0	0.9	7.4	ns
7.8: % of people using improved drinking water source	1.6	4.4	3.5	-0.07
- average GBS ratio in each category (%)	0.0	1.1	9.6	ns
HDI: Human Development Index	0.03	0.04	0.04	0.29
- average GBS ratio in each category (%)	0.0	1.2	6.5	***

*Notes: (1) full sample for indicators 2.1 and 3.1; (2) correlation coefficient levels of significance: ***=1%; **=5%; *=10%; (3) For the GBS/GDP measure for MDG 2.1, the lower threshold was fixed to 0.002%, as more than one third of countries received no GBS.*

Source: Beynon/Dusu (2010, Annex).

Table VI.2: GBS ratios (2002-07) and change in MDG indicators (Africa)

	GBS/ODA			
	L	M	H	Pearson
2.1: primary enrolment rate (% point) (1)	1.1	12.2	14.0	0.45
- average GBS ratio in each category (%)	0.3	3.4	8.8	***
3.1: education gender disparity ratio (% point) (1)	2.9	4.6	6.4	0.22
- average GBS ratio in each category (%)	0.3	3.1	8.3	*
4.1: under 5 mortality rate (deaths/1000, + = reduction)	24.6	11.5	20.6	0.09
- average GBS ratio in each category (%)	0.3	2.8	8.1	ns
7.8: % of people using improved drinking water source	3.4	4.5	4.4	0.04
- average GBS ratio in each category (%)	0.3	2.6	8.1	ns
HDI: Human Development Index	0.03	0.03	0.05	0.38
- average GBS ratio in each category (%)	0.3	2.8	8.1	**

*Notes: (1) full sample for indicators 2.1 and 3.1; (2) correlation coefficient levels of significance: ***=1%; **=5%; *=10%*

Source: Beynon/Dusu (2010, Annex).

			GBS/GDP					
	Spearman	T-test	L	M	H	Pearson	Spearman	T-test
	0.13	0.05	1.1	1.5	6.4	0.00	0.21	0.02
	ns		0.0	0.1	1.3	ns	**	
	0.36	0.00	0.4	1.5	5.1	0.23	0.44	0.00
	***		0.0	0.1	1.7	***	***	
	0.15	0.02	8.7	13.1	16.5	0.08	0.24	0.00
	ns		0.0	0.1	1.6	ns	***	
	0.11	0.02	1.3	3.5	4.7	-0.04	0.22	0.00
	ns		0.0	0.1	1.5	ns	**	
	0.22	0.04	0.04	0.04	0.04	0.24	0.17	0.18
	**		0.0	0.0	0.9	***	**	

			GBS/GDP					
	Spearman	T-test	L	M	H	Pearson	Spearman	T-test
	0.43	0.00	2.8	8.1	16.1	0.49	0.45	0.01
	***		0.0	0.4	2.0	***	***	
	0.32	0.03	1.9	5.6	6.3	0.39	0.43	0.01
	**		0.0	0.3	1.8	***	***	
	-0.16	0.26	23.1	12.0	21.6	0.18	-0.07	0.40
	ns		0.0	0.3	1.8	ns	ns	
	0.01	0.27	3.1	4.8	4.4	-0.08	0.02	0.22
	ns		0.0	0.3	1.8	ns	ns	
	0.35	0.05	0.03	0.03	0.05	0.35	0.35	0.04
	**		0.0	0.3	1.6	**	**	

Annex VII: About IOB

Objectives

The remit of the Policy and Operations Evaluation Department (IOB) is to increase insight into the implementation and effects of Dutch foreign policy. IOB meets the need for the independent evaluation of policy and operations in all the policy fields of the Homogenous Budget for International Cooperation (HGIS). IOB also advises on the planning and implementation of evaluations that are the responsibility of policy departments of the Ministry of Foreign Affairs and embassies of the Kingdom of the Netherlands.

Its evaluations enable the Minister of Foreign Affairs and the Minister for Development Cooperation to account to parliament for policy and the allocation of resources. In addition, the evaluations aim to derive lessons for the future. To this end, efforts are made to incorporate the findings of evaluations of the Ministry of Foreign Affairs' policy cycle. Evaluation reports are used to provide targeted feedback, with a view to improving the formulation and implementation of policy. Insight into the outcomes of implemented policies allows policymakers to devise measures that are more effective and focused.

Organisation and quality assurance

IOB has a staff of experienced evaluators and its own budget. When carrying out evaluations it calls on assistance from external experts with specialised knowledge of the topic under investigation. To monitor the quality of its evaluations IOB sets up a reference group for each evaluation, which includes not only external experts but also interested parties from within the ministry and other stakeholders. In addition, an Advisory Panel of four independent experts provides feedback and advice on the usefulness and use made of evaluations. The panel's reports are made publicly available and also address topics requested by the ministry or selected by the panel.

Programming of evaluations

IOB consults with the policy departments to draw up a ministry-wide evaluation programme. This rolling multi-annual programme is adjusted annually and included in the Explanatory Memorandum to the ministry's budget. IOB bears final responsibility for the programming of evaluations in development cooperation and advises on the programming of foreign policy evaluations. The themes for evaluation are arrived at in response to requests from parliament and from the ministry, or are selected because they are issues of societal concern. IOB actively coordinates its evaluation programming with that of other donors and development organisations.

Approach and methodology

Initially IOB's activities took the form of separate project evaluations for the Minister for Development Cooperation. Since 1985, evaluations have become more comprehensive, covering sectors, themes and countries. Moreover, since then, IOB's reports have been submitted to parliament, thus entering the public domain. The review of foreign policy and a reorganisation of the Ministry of Foreign Affairs in 1996 resulted in IOB's remit being extended to cover the entire foreign policy of the Dutch government. In recent years it has extended its partnerships with similar departments in other countries, for instance through joint evaluations and evaluative activities undertaken under the auspices of the OECD-DAC Network on Development Evaluation.

IOB has continuously expanded its methodological repertoire. More emphasis is now given to robust impact evaluations implemented through an approach in which both quantitative and qualitative methods are applied. IOB also undertakes policy reviews as a type of evaluation. Finally, it conducts systematic reviews of available evaluative and research material relating to priority policy areas.

Evaluation reports of the Policy and Operations Evaluation Department (IOB) published 2008-2012

(Evaluation reports published before 2008 can be found on the IOB website: www.minbuza.nl/iob)

IOB no.	Year	Title evaluation report	ISBN
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Policy and Operations Evaluation Department (IOB)
070-348 6498

September 2012

Published by:

Ministry of Foreign Affairs
Policy and Operations Evaluation Department (IOB)
P.O. box 20061 | 2500 EB The Hague | The Netherlands
www.rijksoverheid.nl/BZ-evaluaties

Authors:
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Translation:
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Photography:
Cover: Budget support: Putting all one's eggs in one basket or walking on eggshells? (Hollandse Hoogte)
Chapter 1: Pollling station Tanzania (2010) (Hollandse Hoogte)
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In the past decade, donors, including the Netherlands, have increasingly supported the budgets of governments in developing countries directly. It was felt that this general budget support would make aid more efficient and effective, and generate more sustainable results. It would also give donors the opportunity to encourage reform through the accompanying policy dialogue.

IOB has concluded that the instrument contributed to economic growth and the extension of public services. Public finance management and democratic control improved as well. Budget support is not suitable for pursuing major reform, however, unless the recipient government takes ownership of it.

Published by:

Ministry of Foreign Affairs
Policy and Operations Evaluation Department (IOB)
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12BUZ612266 | E