Future of EU budget support to developing countries

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PURPOSE: to put forward a Green Paper on the future of EU budget support to third countries.

BACKGROUND: the Millennium Development Goals (MDGs) set in 2000 galvanised international support for development and triggered other initiatives to increase the volume and effectiveness of aid. One of these initiatives was budget support which was the subject of a Commission communication in 2000.

Budget support has now become an increasingly prominent element of the aid effectiveness agenda. Over the period 2003-2009, the European Commission made budget support commitments totalling over EUR 13 billion (about 25% of all commitments in this period). About 56% of commitments were made in Africa, Caribbean and Pacific (ACP) countries, 24% in neighbourhood countries, 8% in Asia, 6% in Latin America and 5% in South Africa.

However, questions about the quality, value for money and impact of budget support are increasingly being raised by a range of stakeholders, including the European Court of Auditors, European and national Parliaments and civil society. This is why the Commission has published this Green Paper the purpose of which is to gather views from stakeholders in order to improve the Commission's approach on the subject. Contributions from interested parties are to be submitted by the end of December 2010 at the latest.

CONTENT: the Green Paper is divided into several parts. The following aspects are covered: i) definition of budget support; ii) experience gained and key principles for the design and implementation of budget support. The last part sets out a number of more contentious issues that form the bulk of this consultation document.

What is EU budget support: budget support is the transfer of financial resources of an external financing agency to the National Treasury of a partner country, following the respect by the latter of agreed conditions for payment. The financial resources thus received are part of the global resources of the partner country, and consequently used in accordance with the public financial management system of the partner country. The EU only provides budget support to countries that meet the following three eligibility criteria, derived from the legal frameworks governing EU support to each region: when there is in place or under implementation a) a well defined national (or sectoral in the case of SBS) policy and strategy; b) a stability-oriented macroeconomic framework; c) a credible and relevant programme to improve public financial management. All disbursements are conditional on continued adherence to these three standard eligibility criteria.

Through budget support, donors help partner governments finance key government functions, such as building schools and hospitals, paying for teachers and health care staff, building infrastructure, improving security and the rule of law, implementing complex reform processes and achieving macroeconomic stability.

Evolution of EU Budget Support: early experience with budget support in the 1990s showed the limits of conditionality as an effective means of promoting reforms; the importance of partner countries owning policies; and the limited effect of targeting funds to specific budget lines.

Regarding eligibility criteria for budget support, the Commission (along with most other providers) applies a dynamic approach by requiring **relevant, credible commitment to reform and evidence of progress rather than compliance with minimum standards**. This approach has allowed the Commission to operate in very diverse contexts, including in countries in situation of fragility, where budget support can underpin stabilisation and avoid deterioration of the economic and political situation.

A major 2006 evaluation of general budget support (GBS) in seven developing countries concluded that budget support had been a relevant response to acknowledged problems in aid effectiveness, and can be an efficient, effective and sustainable way of supporting national poverty reduction strategies. It found that GBS had positive effects on harmonisation and alignment, and on strengthening government ownership and accountability. It also had positive effects on the efficiency of public expenditure, and on government capacity, particularly in public finance management. Budget support had also led to improvements in access to services in most countries. There was no evidence of significant crowding out of private investment or of undermining domestic revenue effort, **nor any clear evidence that budget support funds were more affected by corruption than other forms of aid**. However, the evaluation expressed reservations about impacts on poverty reduction and the quality of basic services.

Main issues: a number of challenges remain to improve the quality, value for money and impact of budget support. Key issues where there is less clarity or consensus on the best way forward are related to:

- political governance and the role of political dialogue;
- role of policy dialogue, role of conditionality, links to performance and results;
- domestic and mutual accountability;
- programming of budget support and its coherence with other instruments;
- strengthening risk assessment and dealing with fraud and corruption;
- budget support in situations of fragility;
- growth, fiscal policy and mobilisation of domestic revenues.

These issues are presented in detail in the communication, together with a number of questions to which stakeholders are invited to respond.

These issues will then be analysed, together with work on an agreed set of objectives and principles, in order for budget support to better contribute to:

- the realisation of the Millennium Development Goals,
- sustained growth,
- poverty reduction in developing partner countries, and
- the promotion of closer economic integration and political association elsewhere.

Building on the results of this and other work, the Commission will work to improve the approach to the design and implementation of budget support, with a view to more coordinated approaches within the EU.