



## Multi-Donor Budget Support: Only Halfway to Effective Coordination

### Summary

Multi-Donor Budget Support (MDBS) has its origins in the critique of traditional aid interventions and is aimed at overcoming related deficiencies of aid by avoiding parallel administrative and decision making structures. It is commonly understood not merely as a financing instrument but also as an instrument with the potential to promote more effective administrative processes and – in the long run – to support democratic accountability.

As a financing instrument, budget support is intended to provide predictable aid flows into the general budget of the recipient. At the same time, MDBS donors also aim at actively strengthening core government capabilities through non-financial contributions, namely conditionality, policy dialogue and targeted capacity building. To be jointly effective, financial and non-financial contributions not only need to be properly aligned to government programmes and priorities but also have to be carefully coordinated among donors – in particular so, if MDBS is provided to countries with weak administrative capacities, high levels of aid dependency and an incoherent state apparatus. In such contexts, donors have to at least partially compensate for these deficiencies with their own harmonisation and alignment efforts.

While MDBS provides for the harmonisation of donor procedures and alignment to government priorities in principle, aligning behind a joint financing mechanism alone is not enough to make MDBS work, particularly since donors are far from having reached a consensus re-

garding the use of political conditionality attached to MDBS. Yet, such conditionality can only be effective (if at all) if applied in a coherent, transparent, and – above all – credible way. This requires (besides the will to reform on the recipient side) a strongly harmonised and coordinated donor approach, which so far has not been sufficiently implemented due to a missing consensus among donors on the relative weight of MDBS's strategic goals.

Some (especially multilateral) donors prioritise the financing function, while for others the political goals related to improving governance are at least as important. So far, donors have failed to establish a consensus on the *hierarchy* of potentially conflicting goals to be pursued with the instrument. In practice, this failure obstructs the creation of coherent incentive systems for recipients necessary for achieving more long-term governance goals.

The lack of such a consensus is caused by different requirements of donor headquarters, which in turn are determined by domestic political concerns. The task of building consensus on what is to be achieved with MDBS and of harmonising the intervention logic accordingly must therefore be taken up at headquarter level. At the same time, headquarters need to delegate actual decision making to their country offices to ensure effective coordination and harmonisation.

Given the dominant role of European donors in the provision of MDBS, this consensus building should be a priority of the ongoing coordination efforts between EU member states and the European Commission.

### 1. Origins of budget support

MDBS is predominantly provided by multilateral development banks, the European Commission and bilateral European donors. It has its origins in the critique of traditional aid interventions and the resulting principles of a new aid agenda, the latter most prominently expressed by core principles of the Paris Agenda (ownership, harmonisation and alignment):

At the micro level, empirical analysis of aid interventions has shown that the proliferation and fragmentation of aid projects and institutions failed to set a coherent incentive system for recipient governments. In addition, numerous organisations and projects weaken recipient state structures by buying off qualified human capital, creating parallel structures and imposing huge transaction costs on aid management, without effectively promoting the systemic changes necessary for sustainable poverty reduction and development. Traditional macro level interventions do not have a good track record either, as they mainly focused on macroeconomic aspects of development and often failed to pay sufficient attention to sector policies and governance issues. Moreover, these interventions often were criticised for simply imposing conditionality instead of deducing conditionality from recipients' own strategies.

Programme-based approaches (PBAs) of the type promoted through the Paris agenda aim at overcoming the traditional ills of aid by avoiding parallel administrative and decision making structures. MDBS as one type of PBA, attempts to achieve this by channelling resources in a harmonised process through the recipient government's budget, while at the same time conditioning support to the implementation of comprehensive development strategies of recipients.

Consequently, the recipient government's budget has become a focal point of donor attention. A government's budget is located at the core of public policy and reflects several dimensions of a government's development orientation by determining which actors, sectors, and pro-

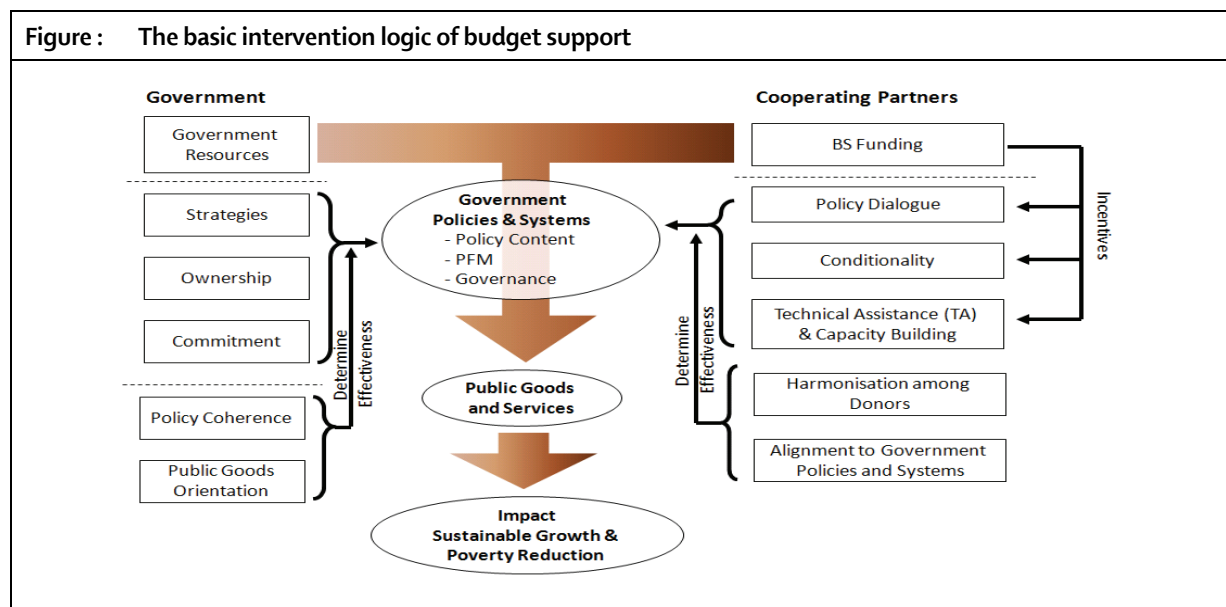
grammes receive public resources. The budget process also reflects important aspects of transparency and democratic accountability, in particular with regard to the oversight function of parliament and the participation of civil society in the political process. Accordingly, MDBS is commonly understood not only as a financing instrument to support national or sectoral development strategies but also as an instrument with the potential to promote more effective administrative processes and democratic governance.

### 2. The intervention logic of budget support

As a financing instrument MDBS is intended to provide predictable aid flows in support of a country's national poverty reduction strategy or similar development plans formulated around the Millennium Development Goals (MDGs). By using recipient governments' own systems for planning, budgeting, implementation and control to channel these resources to fund public goods and services, MDBS is intended to contribute to the promotion of government ownership and accountability, the reduction of transaction costs in aid delivery, the overall harmonisation of donor procedures and to more aid predictability and thus improved planning and allocation of resources.

Thus, MDBS is more than a mere financing modality. In addition to relying on recipients' own systems and processes for channelling aid resources in order to reduce transaction costs and eliminate parallel structures, donors also aim at actively strengthening core recipient governments' budgetary and finance management capabilities. To this end, donors flank the financial with non-financial contributions, namely conditionality, policy dialogue and targeted capacity building. In doing so, the non-financial MDBS contributions work to enhance the effectiveness and impact of the financial contributions provided. Conversely, by conditioning disbursements to specific process or performance indicators, donors hope to create incentives that increase the effectiveness of their non-financial contributions. The figure below illustrates this intervention logic of mutually reinforcing financial and non-financial inputs.

Figure : The basic intervention logic of budget support



Budget support thus simultaneously aims at providing predictable funding and at passively and actively strengthening government systems to make better use of these resources. In doing so, budget support is also expected to contribute to a wider good governance agenda. Channeling aid through the budget and promoting government transparency around the budget process create an important precondition for the strengthening of key oversight institutions such as civil society, parliament, and audit institutions, and in the long-term, democratic participation and accountability.

### 3. Challenges for effective implementation of budget support

To be jointly effective, financial and non-financial inputs not only need to be properly aligned to government programmes and priorities but also have to be carefully coordinated among donors. These coordination efforts are particularly important as MDBS is mostly provided to countries with weak administrative capacities, high (albeit often decreasing) levels of aid dependency and an incoherent state apparatus. These countries have serious difficulties in developing coherent development plans and aligning a group of heterogeneous donors around it. Thus, until adequate coordination capacities on the recipient side are developed, donors have to at least partially compensate for these deficiencies by strengthening their own harmonisation and alignment efforts.

By establishing a common financing mechanism budget support in principle provides for the harmonisation of donor procedures and alignment to government priorities. However, aligning behind a joint financing mechanism alone is not enough to make the intervention logic work in practice. Effective harmonisation is required in the application of the non-financial inputs of MDBS as well, in particular with regard to the two levels of MDBS conditionality.

**Box: Two levels of budget support conditionality**

Budget support is usually provided on the basis of a set of **underlying principles**. These serve as the underlying conditionality for providing budget support and typically include (i) macro-economic stability, (ii) government commitment to implement a national development and poverty reduction strategy (iii) commitment to implement reforms in the area of public financial management (PFM), and (iv) commitment to democratic principles and respect for human rights.

In addition, donors and recipient governments regularly negotiate a **Performance Assessment Framework (PAF)** with sets of process and performance indicators measuring government performance in areas such as the implementation of sector strategies, PFM reforms and other areas of governance. Donors link their disbursements in different ways to these indicators, for example either as a fixed tranche based on overall PAF-performance or as floating or performance tranches linked to individual PAF indicators.

At the level of the PAF conditionality, a lack of consensus among donors regarding the scope of the PAF and the appropriate type of indicators clearly undermines the coherent incentive structure required to induce the policy changes donors hope to see. For one, this applies to the coherent use of process versus performance indicators. More importantly, however, donors tend to overload the PAF with sector indicators. This tendency is due to a classic collective action problem: overloading the PAF often reflects the interests of individual donors to micro-manage and provide additional political leverage to their specific sector activities rather than promoting the collective objective of the donor group as a whole.

The potential for conflict is even larger between the financing goal and wider governance objectives donors hope to achieve with MDBS. Especially so because many (mostly bilateral) donors do not settle for the (more indirect) long-term governance effects of budget support such as improved parliamentary oversight and civil society participation in more transparent budgetary processes, or a more effective auditing function, which can take many years to materialize, if ever. Instead, various donors understand the underlying principles as a potentially powerful political conditionality to pursue more immediate democracy promotion objectives in recipient countries, especially in times of crisis. Yet, evidence for the effectiveness of political conditionality in aid is mixed at best. The successful promotion of governance changes through MDBS conditionality in the short run thus seems highly unlikely unless it is applied in a fully coherent, transparent, and – above all – credible way. This – besides a minimum of willingness to reform on the recipient side – requires a strongly harmonised and coordinated donor approach.

Notwithstanding this necessity, budget support donors are far from having reached a consensus with regard to the role of underlying principles regarding human rights, democracy and good governance: for one, there is disagreement among donors whether or not budget support (or any other aid instrument) should be directly linked to political conditionality. Moreover, even where there is agreement on such underlying principles, usually each donor agency reserves its right to unilaterally interpret the fulfilment or breach of these principles in specific situations. In the absence of a “neutral” or harmonised arbitration authority this means that some donors might interpret political events such as the discovery of large corruption cases as a cause for at least temporarily suspending disbursements, while others might interpret the same event as evidence for improved transparency and oversight and will continue or even increase their payments.

Evidently, in order to achieve governance results by making use of the potential political leverage of MDBS, better harmonized incentive systems are crucial. Importantly, harmonisation in this regard does not necessarily imply uniform behaviour; but it does require that only clear and unambiguous messages are conveyed to the recipient

government and public by all donors involved. Yet, there seems to be little agreement on the relative weight of the strategic goals of MDDBS: some donors (especially multilateral organisations) prioritise the financing function, while for others the more political goals are at least of equal importance. Unfortunately, when one instrument is to achieve several objectives, efficiency losses are often inevitable unless there is a clear ranking of objectives with regard to their relative importance.

The resulting coordination problem is therefore not merely about different prioritisation of otherwise complementary objectives of the instrument; it is about establishing a consensus on the *hierarchy* of potentially conflicting goals, that is, a common understanding of which objective should be subordinate to the other in a particular case of conflict. This consensus has not been established so far.

#### 4. Conclusion and recommendations

The central explanation for different interpretations of the goal hierarchy and for insufficient harmonisation is the different standards, procedures and requirements provided by donor headquarters. For bilateral donors (whose budget support decisions are subject to far more direct parliamentary scrutiny than those by multilaterals), these are usually determined by the specific necessities of domestic political cycles and constellations, in particular in the relation between parliament and the executive. But also within aid agencies, there are important diverging interests: while sector experts focus on the poverty financing dimension of aid, macro-economists and governance experts interested in democracy promotion tend to prioritize systemic changes and thus the wider governance objectives of aid.

The task of building consensus on what is to be achieved with budget support and of harmonising the intervention logic accordingly must therefore be taken up at headquarters level. In the next step, however, headquarters would

need to delegate more actual decision making to their country offices to ensure effective coordination and harmonisation in the application of this intervention logic.

Otherwise, if donors do not manage to substantially improve harmonisation in this way, they will have to lower their expectations of what MDDBS can possibly achieve: based on empirical evidence, it seems that the financing function related to pro-poor spending can be (partially) effective even with less than perfect harmonisation. There is also evidence for MDDBS to have at least some positive impact on public financial management and budget oversight despite imperfect harmonisation of the intervention logic – not least because donors share the common goal to strengthen these institutions in order to minimise their own fiduciary risks. Evidently, MDDBS could be more effective in both these dimensions (and thus also in the more indirect long-term governance dimension) if the created incentive structures were better harmonized and more coherent. However, long-term governance goals such as promoting general democratic governance and respect for human rights are likely to be the most seriously affected by harmonisation deficiencies. Such reforms tend to bear high political costs for recipient governments that eventually need to be compensated by clear and strong incentives created by donors.

If MDDBS is to achieve its objectives on all three levels, strict harmonisation and coordination based on a clear and jointly shared hierarchy of these objectives is therefore required. For this to be achieved, a more clearly spelled-out common intervention logic of MDDBS needs to be agreed among donors.

Given the dominant role of European donors in the provision of MDDBS, this consensus building should be a priority of the ongoing coordination efforts between EU member states and the European Commission.



**Dr. Jörg Faust**  
*Head of Department III  
German Development  
Institute*



**Svea Koch**  
*Researcher, Department I  
German Development  
Institute*



**Stefan Leiderer**  
*Researcher, Department I  
German Development  
Institute*