Comments on “Budget Support by the European Union: What Do the External Evaluations Tell Us?”

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This paper is a useful description of the European Union’s budget support instrument and a faithful synthesis of the 17 independent evaluations of budget support operations. There are many distinctive aspects of the EU’s budget support programs, some of which are highlighted in the chapter. The synthesis of the evaluations paints a generally favorable view of EU budget support although, as acknowledged in the chapter, without a counterfactual analysis the true impact cannot be discerned. In my comments, I look first at the implications of the distinctive characteristics of EU budget support for development effectiveness more generally, as well as for the evaluations themselves. Next, I raise some issues from the evaluation synthesis. Finally, I offer some comments on the budget support instrument aimed at fragile states, the state and resilience building contract (SRBC).

1. Characteristics of the European Union Budget Support Instrument

The two main distinguishing characteristics of EU budget support are that: (i) it is provided exclusively in the form of grants rather than loans, and (ii) it is disbursed based on observable and monitorable indicators of performance, such as progress in implementing public financial management reforms or restoring macroeconomic balance. These make EU budget support different from, say, budget support operations of the World Bank or the African Development Bank, which mainly provide loans (some of which are concessional) and disburse based on prior policy actions rather than results.

Grants, Not Loans

The fact that the EU provides grants has implications for the definition of the appropriate macroeconomic framework. While everyone agrees that you should give budget support only in a stable macroeconomic environment (hence the EU’s collaboration with the IMF), the definition of “a stable macroeconomic environment” may be somewhat different if the country does not have to repay a loan. For instance, there may be countries in debt distress who would not be eligible for World Bank loans but who could still use the resources productively if they were provided as grants. Hence, the macroeconomic framework for EU budget support may not necessarily be the same as those of the IMF or World Bank. There is also a question of whether countries that are not in debt distress should spend the grants for current expenditure (as they seem to have done) or to use them to leverage greater financing for investment projects. The latter may be the best use of EU budget support, especially in countries with huge infrastructure deficits, but it may not be common practice and may even be prohibited because of the restriction that EU budget support cannot be used to build up foreign exchange reserves.

Performance-Based Disbursements

Disbursement of EU budget support is based on progress in meeting certain benchmarks that are agreed upon at the beginning of the program. The disbursement can be full (fixed-tranche) or partial (variable-tranche) if the progress itself was only partial. This is in contrast to the approach taken by the multilateral development banks, whose budget support is disbursed based on policies undertaken ("prior actions") rather than on results. To the extent that there is a difference between *ex ante* policies and *ex post* performance, one wonders how countries are able to coordinate across their budget support donors. For instance, if a country failed to undertake some prior actions but still met the performance criteria, the World Bank would not disburse but the EU would release its tranche. Conversely, if a country met its prior actions but missed the performance criteria, the World Bank would disburse but the EU may not. These situations have implications for the multi-donor evaluations conducted for about 11 countries. In fact, the cases where these discrepancies occurred could teach us a lot about the effectiveness of the two different disbursement criteria.

Furthermore, performance-based conditionality (PBC) raises three issues of its own. First, inasmuch as development is a risky business—we often do not know if a certain policy reform will yield the expected outcome—PBC puts all the risk onto the recipient. If the policy reform fails, the EU does not disburse. With conditionality based on *ex ante* policies, the donor and recipient are sharing the risk: if the policy reform fails, the donor also loses because they have already disbursed the money. To be sure, the reason behind PBC is to increase the results focus of recipient governments and to increase the incentives to undertake the necessary reforms. However, these benefits should be weighed against the risk-sharing aspects of PBC, which are clearly biased against the recipient. It appears that the EU recognized this when it decided to introduce variable tranches, so as not to risk all the disbursement on one set of performance criteria being met.

Second, other attempts at performance-based conditionality, such as the World Bank's Program for Results, have found that there is a tendency to "dilute" the performance criteria (so as not to risk failing to disburse) to the point where they resemble *ex ante* policy conditions.[1] The reality is that both the donor and recipient have an interest in seeing the operation disburse and therefore may, even subconsciously, nudge the conditions in that direction. It is possible that this is happening with EU budget support as well. Some of the examples cited, such as public financial management reforms or budget transparency, are quite similar to the policy conditions in World Bank budget support operations. The fact that the 199 budget support programs between 2014 and 2019 had an average disbursement rate of 83% also suggests that the conditions may have been close to having been met when they were selected.

Third, the chapter notes, approvingly, that in addition to budget support, the EU provides technical assistance (TA) to countries to further progress on key areas such as public financial management. While it is desirable that EU TA, budget support conditions, and policy dialogue are all pulling in the same direction, there may also be some problems here. If the EU is providing technical assistance in an area that is also a performance criterion for tranche release, at least two things could happen. If the country fails to meet the performance criterion, it could blame it on the TA; or the organization providing the TA could try to influence the EU into certifying that the country had met the criterion, lest its own performance be judged as mediocre. Even if the TA and budget support operation are kept

[1] Alan Gelb, Anna Diofasi, and Hannah Postel. 2016. Program for Results: The First 35 Operations. *Center for Global Development Working Paper No. 430*. Washington, DC: Center for Global Development.

independent, since both are being provided by the same institution, it is difficult for the country to not perceive them as linked. Moreover, there is a cost to aligning the TA too closely to the performance benchmarks in that the country may benefit from technical assistance in addressing some longer-term reform issues (e.g., energy subsidies, and anti-trust laws) which, being politically sensitive, may not be included in a budget support operation.

2. Synthesis of Evaluations

The independent evaluations that are synthesized in the chapter all follow a particular, three-step framework. First, the effects of the budget support operation on policies and institutions are analyzed. Next, the outcomes and outputs in a country are related to policy and institutional changes. Finally, the results of the first two steps are combined to provide a narrative of how the budget support operation, through its contribution to policy and institutional change, helped achieve outcomes and impacts.

What is the Counterfactual?

While the chapter notes that in some of the individual steps there is an attempt to specify a counterfactual, the overall narrative does not have one. Yet, without a well-specified counterfactual, it is difficult to interpret the evaluations. We do not know how the economy would have evolved in the absence of the budget support operation. For instance, if Mali increased priority-sector spending in the period of the EU budget support, by how much would they have increased it in the absence of such support? If Burkina Faso's public financial management improved during its budget support period, by how much would it have improved without budget support? These questions are important not just for gauging the effectiveness of the budget support instrument but also for understanding how budget support can help a country.

One way of constructing a counterfactual is to compare a country with another country with similar characteristics that did not receive a budget support operation from the EU. This cross-country analysis has been used in other evaluations of budget support operations.[2] Another is to compare the same country's performance in two periods of time, one where there was a budget support operation and one where there was not. Here, you would need to adjust for other factors, such as a terms-of-trade shock, that may have affected the economy during the budget support phase but were unrelated to the operation. For instance, if a country experienced a favorable terms-of-trade shock during the period of the operation, the success of the operation may have been due to the shock and not to the operation.

Bundling of Financial and Knowledge Assistance

The value of having a counterfactual goes beyond just having a better estimate of the project's impact. It also helps us disentangle the different components of budget support. As the synthesis notes, budget support operations have three components: a transfer of resources, technical assistance, and a dialogue on policy reforms aimed at achieving the targets of the operation. What is the relative importance of each? For instance, in Mali, Uganda, Zambia, and other low-income countries, the evaluations found

[2] William Easterly. 2003. IMF and World Bank Structural Adjustment Programs and Poverty. In Michael P. Dooley and Jeffrey A. Frankel, eds. *Managing Currency Crises in Emerging Markets.* Chicago: University of Chicago Press.

that the financial transfer created fiscal space for these countries to increase priority expenditures (or at least not cut them during a period of austerity). What role did the policy dialogue play in these instances? Would they not have increased spending on priority sectors in the absence of dialogue (but with the financial transfer)? After all, these sectors were included in the government's priorities. Meanwhile, the Burkina Faso evaluation concluded that policy dialogue led to significant improvements in the country's public financial management. These reforms did not cost the country very much. Would Burkina Faso have carried them out without the financial transfer?

The chapter notes that many of the evaluations discussed the relative contributions of the financial transfer ("flow of funds"), technical assistance, and policy dialogue, but this seems to be based on the relative magnitude of the financial transfer and the intensity of TA and policy dialogue, rather than on a model of the combined effect of the three on outcomes. Nevertheless, it is worth noting that the chapter finds that the flow of funds played a greater role in the general budget support operations than in sector budget support. The reason could be that the sector budget support operations were concentrated on middle-income countries, including some upper middle-income countries, whereas the financial transfer represented a tiny portion of the government's budget (0.6% as opposed to 15% for general budget support).

In addition to their relative contributions, we need to know the interaction between financial and knowledge assistance. For example, when in 2010, many EU member states stopped providing budget support because of questions about the use of aid funds, they were clearly concerned about the financial transfer. If there was a way to reduce the size of the financial transfer and intensify the policy dialogue, it may have been possible to address these concerns.[3]

The bundling of finance and policy dialogue into budget support raises the broader question of why they should be bundled. If these policy reforms benefit the country, why do they not do them anyway? Why is it necessary to accompany them with money? One answer is that the financial transfer acts as an encouragement for the government to undertake the reforms. But this implies that the government was not sufficiently committed to reforms in the absence of the transfer, which suggests that the reforms are not genuinely owned by the government. Another possible answer is that the additional resources enable the reformist elements in government to convince the non-reformists that the reforms are worth doing. Again, this suggests that the reforms are not collectively owned by the whole of government. Then the financial transfer is helping to fix (usually on a temporary basis) a fundamental political-economy problem in the country. It is not clear that such solutions are sustainable. It is also not clear that external actors such as the EU or World Bank can or should be selecting reform champions in the country. In Zambia in 1991, a new finance minister convinced the World Bank and IMF that the government was serious about reform and signed a series of budget support operations that involved, inter alia, maize price reforms. It turned out that the finance minister had not consulted with the agriculture minister, who was responsible for maize prices. The agriculture minister refused to sign off on the reform and the operation was cancelled.[4]

Problems with Financial Transfers

[3] At the World Bank, we once explored the possibility of a "zero-dollar budget support operation" to a country that wanted the operation because of the discipline it would provide in maintaining a reform agenda but whose corruption indices were so high that a financial transfer to the budget would not have been approved by the Board. The project did not go ahead because of concerns that it would be seen as mocking the Board's objections to financial transfers to the country.

[4] Lise Rakner, Nicholas van de Walle, and Dominic Mulaisho. 2001. Zambia. In S. Devarajan, D. Dollar, and T. Holmgren, eds. *Aid and Reform in Africa.* World Bank.

The financial transfer associated with budget support can have two other effects that may not be conducive to better development outcomes. The synthesis in the chapter hints at some of them but does not develop their implications. The first is the fungibility of aid resources, which is mentioned in the chapter. Since the financial transfer goes directly to the government's budget, it could in principle be used for any expenditure. Several of the evaluations speak favorably of the fact that pro-poor expenditures on, for example, health, education, and social protection rose during a budget support operation. But if the country was planning on increasing spending in these sectors anyway, then the EU's finance was being used to finance some other expenditures, about which we know very little. This is not just a theoretical possibility. There is evidence on the fungibility of aid in general.[5]

The second problem with the financial transfer links back to the political-economy problem mentioned earlier. If the reason why the policy reform was not implemented before was that there was not a political consensus in government in favor of the reform, then does a financial transfer help or hurt? The typical answer is that it helps "grease the wheels," permitting reformists to bring non-reformers on board. But there is evidence that financial transfers may have the opposite effect, namely, they give governments the breathing room to postpone, or even avoid, reforms. The World Bank gave three budget support operations in a row to Kenya for the same maize price reform.[6] In fact, in 1992, the one year that donors withdrew their support to Kenya, the country implemented a series of sweeping reforms, including a tax reform that has given Kenya one of the highest tax-to-GDP ratios in Africa. As Michael Bruno, the chief economist of the World Bank at the time, put it, "We did more for Kenya in that one year than we did during the previous thirty years." In short, the bundling of finance and policy dialogue, which is a hallmark of budget support operations, may not be the best way of achieving results when the underlying problem is domestic politics.[7]

Effectiveness of Public Expenditures

Most of the evaluations seem to equate increased public spending on health and education with improved health and education outcomes. Unfortunately, the evidence for this link is weak at best.[8] The reason is that the delivery of basic services in health and education is poorly targeted and often ineffective (often because of absentee teachers or doctors). In fact, the chapter notes this discrepancy by pointing out that the "gains were momentous but not always equitable…and gains in access have not always been accompanied by better quality of services." The evaluations should have been more circumspect in claiming that, since the budget support operations were associated with increased spending in these sectors, they contributed to better outcomes in those sectors. Indeed, the observation that "the provision of budget support coincided with a period when social indicators significantly improved…" says more about economic growth during this period (it was a time of high commodity prices) than about increased spending.

Country Context

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[5] Tarhan Feyzioglu, Vinaya Swaroop, and Min Zhu. 1998. A Panel Data Analysis of the Fungibility of Foreign Aid. *The World Bank Economic Review.* Vol. 12. No.1. pp. 29-58.

[6] F. Stephen O'Brien and Terry Ryan. 2001. Kenya. In S. Devarajan, D. Dollar and T. Holmgren, eds. *Aid and Reform in Africa.* Washington, DC: World Bank.

[7] Shantayanan Devarajan and Stuti Khemani. 2018. If Politics is the Problem, How Can External Actors be Part of the Solution? In K. Basu and T. Cordella, eds. *Institutions, Governance and the Control of Corruption.* Cham, UK: Palgrave Macmillan.

[8] World Bank. 2003. *World Development Report 2004: Making Services Work for Poor People.* Washington, DC: World Bank.

The country evaluations seem to have been narrowly focused on the EU budget support operation, its performance indicators, and the observed outcomes. There is little mention in the synthesis about the overall context in those countries. Sometimes, that context calls into question the validity of the evaluation. For example, the synthesis speaks favorably about Mozambique's "improved budget documentation and legislative and institutional framework for the control of corruption." Yet this is the same country that had a huge scandal because it hid its debt; and the former finance minister is facing extradition from South Africa for corruption charges. Similarly, budget support to Tunisia "contributed directly to the country's opening to international trade and coincided with a period of economic growth and stability." But this period was followed by the Arab Spring when President Ben Ali was thrown out of power. Furthermore, there is evidence that the period of Tunisia's opening to international trade was also one of elite capture when certain industries (e.g., transport, telecommunications, and banking) received protection from foreign competition because firms in these sectors were owned by members of the Ben Ali family.[9]

3. Budget Support to Fragile States

The third instrument, the state and resilience building contract (SRBC) is a welcome addition to the EU's budget support instruments and has already proved to be extremely useful in disasters such as the Ebola crisis and more recently the coronavirus disease (COVID-19) pandemic.[10] The fact that the eligibility criteria of SRBCs are different from those of other EU instruments is key. If SRBCs applied the eligibility criteria of the SDG-Cs, most of these fragile states would not qualify. That said, the essential feature of fragile states is that the government no longer has a monopoly on violence. But most of the actions associated with the instrument seem to be exclusively with the government. The budget support goes directly to government and the policy dialogue is aimed at strengthening "government capacities." If the government is incapable of protecting its citizens with its security and other basic services, it is unlikely to be able to build these capacities in the short run. There should be more thinking about how development partners can to help the private sector in these fragile states, since they are the only source of growth. Many of the basic services in these fragile countries are delivered by the non-state sector, which may be able to scale up faster at short notice than the government.

Second, there should be consideration of the fact that many of these countries are caught in a "fragility trap", in which case, incremental solutions based on the principles used for non-fragile states are unlikely to help them escape that trap.[11] Specifically, the macroeconomic analysis, including that conducted by the IMF, does not take into account the possibility of a low-level equilibrium trap.[12] In

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[9] B. Rijkers, C. Freund, and A. Nucifora. 2017. All in the Family: State Capture in Tunisia. *Journal of Development Economics.* Vol. 124, Issue C, pp. 41-59.

[10] There is some ambiguity as to whether the SRBC, which is seen as an instrument for emergency support in pandemics, earthquakes, and other disasters, is restricted to fragile states. For instance, the SRBC was used in Nepal after the 2015 earthquake. Similarly, there are plans to use it for countries hit by the Covid-19 pandemic, most of which are not fragile states.

[11] Paul Collier, Timothy Besley, and Adnan Khan. 2018. *Escaping the Fragility Trap.* London: International Growth Centre.

[12] N. Andrimihaja, M. Cinyabuguma, and S. Devarajan. 2011. Avoiding the Fragility Trap in Africa. *World Bank Policy Research Working Paper*. Washington: World Bank.

some cases, these countries will need a large amount of aid, much larger than that yielded by the standard macroeconomic formulae, in order to escape the fragility trap.

Third, the discussion on domestic resource mobilization in these countries should be strengthened. Taxation is not just a way of generating revenue for government. It is also a means of building solidarity among an often fragmented population around the common good.