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**Budget Support in Fragile States:
Feeding the Beast or Building Resilience?**

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Abstract

Budget support is an aid modality that has been making headlines, usually triggered by cases of corruption or unsavoury moves by recipient governments. Such headlines raise questions about the impact of budget support, and suspensions thereof, both on the poorest citizens in the recipient countries, and on the elite bargains made behind closed doors: does budget support feed the beast of exclusionary elites and institutions, or does it foster accountability and inclusion?

Arguing that accountability specifically, not capacity, determines the appropriateness of budget support to fragile states, this policy paper distinguishes fragile states where it can be beneficial from those where it likely to do harm. And in those countries that are promising, budget supporters should squarely aim for statebuilding and social cohesion, rather than focus on short-term results and “hope for the best” regarding long-term outcomes.

Keywords

Budget support; fragile states; governance; inclusion.

“Where circumstances permit, budget support is the most effective instrument of development”

—Louis Michel, European Commissioner for Development and Humanitarian Aid, 2008

“Simple budget support is the type of aid most likely to be siphoned off by extractive political elites”

—Daron Acemoglu and James Robinson, 2012

Introduction*

Budget support—aid that is channelled directly to a partner government’s treasury using this government’s own systems, and is not linked to specific projects (Box 1)— is an aid modality that has been making headlines, usually triggered by cases of corruption or unsavoury moves by recipient governments. Most recently, the suspension of UK, Dutch, German and EU budget support to Rwanda following a United Nations report documenting Rwanda involvement in DRC’s rebellion *du jour* (UN Group of Experts, 2012), has raised questions about the impact of budget support, and suspensions thereof, both on the poorest citizens in the recipient countries, and on the elite bargains made behind closed doors. Does budget feed the beast of exclusionary elites and institutions, or does it foster accountability and inclusion?

Diplomats often lead on international efforts to help fragile states from Afghanistan to Zimbabwe increase their ability to manage crisis, and “budget support” are two words that usually make their eyes glaze over. They often think it is just an aid modality that, like all aid modalities has its risks and rewards in terms of disbursement and fiduciary risk. But of all instruments budget support is probably the one that can do the most good (or the most damage) to the pact between the government of a fragile state and its citizens: budget planning and execution are where citizens’ expectations meet the reality of the state’s ability to arbitrate between competing priorities and deliver services, and therefore where citizens’ expectations are shaped and the legitimacy of the state is forged.

Budget support in developing countries generally has many well-documented benefits for partner countries, mainly (i) macroeconomic stabilization; (ii) a rapidly visible increase in resources, expenditures and services in the partner government’s priority areas; (iii) greater national leadership, with increased capacity to agree priorities across government ministries, to plan and to manage resources over the medium term; (iv) over time improved government accountability to citizens, centered on the budget process (IDD and Associates, 2006; DFID 2008; OECD 2011; ODI, 2010; Oxfam, 2011 ; Collier, n.d.). Budget support also holds benefits for donors specifically: it (i) facilitates donor alignment to national priorities, systems and to the budget cycle, and therefore coordination among donors, meaning greater collective impact on development outcomes; (ii) puts donors in a good position for constructive government-donor dialogue on policies and priorities and to demand accountability of public resources; (iii) is “*bureaucracy’s nirvana*” (Collier, n.d.), as it allows for large disbursements on schedule and with limited overhead costs.

On the flip side, it is also true that budget support can be a risky investment, at least in reputational terms. Contrary to a widely held assumption, there is no empirical evidence to date that budget support carries higher fiduciary risks—risks that the donors’ funds are not used for the intended purposes, or not efficiently, and/or are not accounted for—than other forms of aid (Box 2). However, donors providing budget support are at much higher risk of seeing their reputation damaged by government decisions that are, by construction, outside their direct control, since budget support is all about supporting national priorities rather than specific projects. In other words, donors are

* The author has benefitted from discussions with colleagues in the European Commission, the World Bank, and the OECD Development Assistance Committee, and from insightful comments from Giorgia Giovanetti, European Union Institute, and Alan Hudson, ONE. The views expressed in this paper are the author’s own, as are any error or omission.

vulnerable to reputational risks the moment there is a case of either corruption or poor judgment, either real or perceived, in the use of the national budget. For example, the government of Tanzania embarrassed its budget supporters for its 2002 decision to purchase a £15 million presidential jet. It is up to donors to compare the opportunity costs that a presidential jet represents, with the benefits of having strengthened country systems and the national bargaining process underlying the budget process. If donors' domestic politics allow for informed dialogue, then the calculation should easily be made: the Tanzanian jet should not keep donors awake at night, since the Tanzanian government provides basic services to its citizens and is accountable to them.

In fragile states—countries that “have weak capacity to carry out basic governance functions, and lack the ability to develop mutually constructive relations with society” (OECD, 2012)—the calculation is rarely obvious. There is usually limited service delivery and poor accountability, and a presidential jet represents an opportunity cost of a different magnitude. When fragile states have weak capacity, how will budget support be spent, if at all? When fragile states have shaky legitimacy, what is the impact of budget support on the quality of state-society relations and the elite political settlement? Are there major differences across fragile states? If so, how to distinguish fragile states where budget support can be, in the words of Louis Michel, “*the most effective instrument of development*” (2008) and where it can be, in the words and Acemoglu and Robinson, “*the type of aid most likely to be siphoned off by extractive political elites*” (2012)? How to maximise the rewards of budget support in promising fragile states while minimising the risks?

While the general (*i.e.* not fragility-specific) literature on budget support is rich, it tends to be focused on technical aspects rather than its transformative impact. And although it is cutting edge there is still little guidance on how to navigate the waters of budget support to fragile states specifically.¹ Taking a political economy view and building on the budget support literature, on recent case studies of budget support in fragile states, and on the international experience with engaging in fragile states, this policy paper aims to distinguish between fragile states where budget support makes sense, and where it is more likely to do harm (part I). It argues that, for budget support to be a worthwhile investment in those countries that are promising, donors should squarely aim for statebuilding—capacity and accountability of the state—and social cohesion (part II).

Box 1. Main aid modalities and budget support

All modalities to channel aid have their own risks and rewards, and a different mix of modalities is suited to different contexts, depending on technical circumstances and the political economy of the partner country. The main aid modalities are (i) balance of payment support; (ii) debt relief; (iii) general budget support, which is budget support for overall rather than sector-specific priorities; (iv) sector budget support; (v) budget support to subnational authorities; (vi) off-budget sector funds; (vii) project aid using government systems and (viii) project aid using parallel implementation systems. They are usually used in conjunction with each other, although with varying degrees of coherence.

The first five modalities are budget support, *i.e.* “*aid that is channelled directly to a partner government using its own allocation, procurement and accounting systems, and is not linked to specific projects*” (CABRI, 2009). The European Commission and the UK are the primary drivers of budget support, with budget support representing one in every four euro committed by the former over 2003-09 (€13 billion), and one in every six euros by the latter over 2010-11 (€770 million). However, to give an idea of its modest magnitude, general budget support represents less than 5% of aid flows to lower income countries, fragile and stable (ODI, 2011).

¹ The main guidance on budget support in fragile states is provided by the European Commission, 2012, and AFDB-World Bank, 2011.

Box 2. Budget support, corruption and fragile states

There is no empirical evidence to date that budget support carries higher risks of corruption than other forms of aid:

- There is “no clear evidence of budget support funds were, in practice, more affected by corruption than other forms of aid” (IDD and Associates, 2006)
- “None of the three evaluations found evidence that the risks many associate with budget support, for example crowding out of domestic revenue and increased corruption have materialised in practice (OECD, 2011a)
- “Potentially, the risks of losses when funding through the national budget may be much greater than in project aid, where the funds are under DFID’s direct supervision, although we have seen no definitive evidence one way or another” (ICAI, 2012)
- “There is no clear evidence that budget support funds have been, in practice, more affected by corruption than other forms of aid” (U4 Anti-Corruption Resource Center, 2012).
- Paul Collier (2009) goes further to say that “in badly governed countries the effect of [project aid] has been the same [as budget support]: the money has been captured by politicians who are the core of the problem. Project aid only gives the illusion of integrity: governments gets donors to finance the projects they would have done anyway, and this releases their own money for the presidential wish list”.

In fragile states, corruption is particularly acute and damaging, but as in other contexts is the symptom of deeply rooted causes, including the lack of domestic accountability and exclusionary institutions. If budget support did carry a higher risk of corruption than other forms of aid, it may nonetheless be a worthwhile risk if it strengthened accountability and inclusion.

Promising and Unpromising Fragile States

Considering needs, the case for budget support in fragile states is very strong: The experience of the past decade shows that, taken as a package that goes beyond a financial transfer, budget support contributes to improving service delivery and to strengthening capacity and accountability, three areas that most need strengthening in fragile states. In fact, taking the two groups of fragile and non-fragile countries, patterns are similar in both amounts and range of budget support received: twenty-three fragile states currently receive budget support, including seven that receive over 10% of their total official development assistance (ODA) as general budget support (Table 1). This ratio varies across fragile states ranging from nil in Zimbabwe and Somalia to 17% in CAR, which is not unlike more stable countries, where it ranges from 2% in Cambodia to 21% in Tanzania.

Considering performance, the case for budget support in fragile states is, at first glance, very weak. It is generally agreed that two conditions need to be met for budget support to be beneficial: (i) an accountability condition: the government has a pro-poor agenda and is accountable to its citizens; (ii) a capacity condition: its allocation, procurement and accounting systems are strong enough to absorb and channel the money (see for example, OECD, 2011a and Paul Collier, n.d.). However, in fragile states, which, by definition, have weak legitimacy and/or capacity, these assumptions rarely meet fact:

- Government priorities are often neither focused nor pro-poor. This can be because elites and institutions are fundamentally exclusionary, concentrating power and hampering development; and/or because government itself is divided (*e.g.* transition coalition governments in Burundi 2001-2005 and DRC 2003-2006; but also governments that are born from a victor/vanquished

scenario, such as the Ouattara government in Cote d'Ivoire from 2011).² In such cases, budget support risks being used to inefficiently fund fragmented activities rather than efficiently support statebuilding (understood as building the capacity of the three branches of government and contributing to constructive state-society relations) and inclusive development. It may also do harm, by exacerbating such divisions and perpetuating fragility and poverty.

- DRC, Sudan, Chad, Zimbabwe, Afghanistan and Haiti have formal elections every four or five years, but also the world's worst human rights records after Somalia (Failed States Index 2012). Beyond elections, when they exist, there is often poor government accountability to citizens, and/or ability to fulfil basic functions of the state such as ensuring the monopoly on the legitimate use of violence and on taxation. In such cases, budget support has little chance of serving a pro-poor agenda.
- The world's weakest public financial management systems are found in fragile states (Chad, Comoros and Sudan: OECD, 2011c). These and other country systems in fragile states—such as for accounting, auditing, procurement, results frameworks and monitoring—are often weak, leading to inefficiencies, opportunities for corruption and aid capture, all which perpetuate fragility and poverty. Moreover, they are usually poorly connected to the national budget cycle, in which case budget support can help get things done and ensure some government-to-donor accountability, but does not do much for government-to-citizens accountability.
- It is usually estimated that fragile states can absorb aid up to around 15-30% of their GDP, which is much lower than for more stable countries (McGillivray and Feeny, 2006). Aid beyond these thresholds can have diminishing returns and possibly do harm by creating opportunities for rents, patronage and corruption.

Considering both needs and performance, in which fragile states would budget support do any good? Among fragile states, AfDB-World Bank (2011) contrasts “*gradual improvers*” (“*countries experiencing credible post-conflict and political transitions*”) and those “*characterised by conflict, prolonged crises or deteriorating economic governance, where budget support may not be advisable*”. In fact it is rather impossible, either in theory or empirically, to confidently classify a fragile state as belonging to the first or second category: fragility is a condition that tends to be chronic—being exposed to large-scale violence is itself a risk of further violence—and few international observers would dare call most fragile states post-crisis within a ten- or twenty years have elapsed since the last major crisis.

Rather this paper argues that accountability specifically, not capacity, determines the appropriateness of budget support to fragile states. According to the definition of fragility and its two dimensions, capacity and legitimacy, there are three broad types of fragile states: those with some legitimacy but weak capacity; those with some capacity but little legitimacy; and the wretched ones cumulating both weak legitimacy and weak capacity. Given that legitimacy is so multidimensional and context-specific—weak legitimacy can stem from poor accountability, poor capacity to deliver service, beliefs shaped by tradition and religion, lack of standing in the international scene, or all of the above (OECD, 2010)—this paper uses accountability, which is one dimension of legitimacy and around which there is a certain consensus, as a proxy, and distinguishes (i) low-accountability countries, comprising the “strong enough but unwilling”, such as Iran, Eritrea and North Korea; and the “weak and unwilling”, such as Somalia and Equatorial Guinea; and (ii) the “weak but willing”, for example Liberia, Burundi, Haiti, Sierra Leone and Timor-Leste.

In low-accountability countries, whether they have weak or strong government capacity, budget support is more likely to do harm than good. General budget support would risk further freeing the regime from any demand from accountability from its citizens and therefore making

² Current studies of fragility often focus on the elites-ordinary citizens divide, but Goldstone *et al.* (2010) find that violence is narrowly correlated with politics being “paralysed or undermined by elite divisions.”

matters worse. Because sector budget support is fungible in the overall budget, sector budget support would have the same effect. As for budget support to subnational authorities, it risks antagonizing the central state and therefore, unless there is a groundswell demanding good governance from the grassroots, to undermine the state-building process. In other words, low-accountability countries need aid, including direct service delivery to save lives and innovative forms of engagement to support change, but they don't need budget support, which is likely to do harm. Box 3 offers some alternatives to budget support.

By contrast, “weak-but-willing” countries are all fertile ground for budget support to yield transformative, systemic benefits. Budget support is not a magic wand and won't transform exclusionary institutions into accountable and inclusive ones. But where there is a modicum of accountability, it can be a powerful accountability multiplier. Weak capacity can be developed, even from the lowest base, as the experience shows for example in Timor-Leste, where the numeracy of the average Timorese Finance Ministry official was at the third grade level after independence, or in DRC where donors supported the development of public financial management and procurement capacities from a post-war ground zero. In extreme cases where it makes disbursing impossible, capacity can even be temporarily outsourced to third parties before it is strengthened nationally. In fact, not only a group of “weak and willing” countries benefit from significant budget support (*e.g.* CAR, Sierra Leone, Burundi and Liberia, Table 1), but it has been found that “*budget support has been used effectively even in fragile situations with extremely weak fiduciary systems, as shown by the experiences of Central African Republic, Haiti and Afghanistan*” (AfDB-World Bank, 2011). The Sierra Leone Minister of Finance, Dr. Samura Kamara, summarized the range of benefits in his country: “*During the war, we had plenty of humanitarian assistance but when we signed the peace agreements, all this aid started to go away. Budget support helped us to support recurrent budget expenditures and to complement the efforts in governance building. It has helped in restoring macroeconomic stability, which is a benchmark if you want to move forward.*”

In practice, how to tell the promising fragile states from those where budget support is likely to do harm? There is a vast grey zone of borderline cases between the Sierra Leones and the Somalias, between the “weak-and-willing” and “low accountability” countries: for example countries where there are formal elections but not much else by way of accountability, or when there are pro-poor reformists within a regime that is otherwise exclusionary. Although indicators to measure accountability and legitimacy abound, in line with current practice³ this paper cautions against the use of indicators to separate the promising cases from the unpromising. There is nothing mechanistic about going from fragility and poverty to resilience and development: as the half-joke goes, the international community did everything right in South Sudan and it turned wrong (in the mid-2000s); everything wrong in Mozambique and it turned right. Rather, context-specific analysis is warranted to establish whether budget support would likely strengthen accountability and inclusion, using for example scenario planning—and most importantly what kind:

- The impact of simple or first generation budget support, usually one-off programmes aimed at macroeconomic stabilization, can be quite different from what is called partnership or second generation budget support, which goes well beyond the transfer of funds to the partner government's treasury and is a package that includes (i) donor-government dialogue focused not only on process but also on the fundamental goals; (ii) a programme to develop the capacities of country systems but also of parliament, audit institutions and civil society; and (iii) a transfer of funds channeled through the budget.

³ IDD and Associates (2006) find that decisions to provide budget support are based on country context, not on a preconceived set of benchmarks. In the same vein, DFID “will not require partner countries to meet a minimum standard of domestic accountability; rather we will be looking for commitment to strengthen domestic accountability” (DFID, 2011) and the European Union will assess “the government's commitment to fundamental values as well as the political response to address them in a comprehensive way” (European Commission, 2012).

- There are also several shades of partnership budget support, involving diverse degrees of donor coordination; of alignment to national priorities and systems; and of government-citizens dialogue. The European Commission (2012) describes a comprehensive and ambitious type of partnership budget support, which explicitly includes statebuilding objectives in fragile states.

Asking whether budget support would likely strengthen accountability and inclusion may in fact be easier to address than the static question of whether, at a point in time, a particular regime is exclusionary or inclusive and accountable, offering economic and social opportunities and political participation. For example, while it is clear for Acemoglu and Robinson (2012) that “*extractive economic institutions [institutions that do not create the incentives needed for people to save, invest, and innovate] and extractive political institutions [institutions that support these economic institutions by cementing the power of those who benefit from the extraction] ... are always at the root of failure*”, Putzel and Di John (2012) recall that “*a uniform approach to opposing rent-seeking may provoke instability and violence, and rent allocation or special privileges allocated to the elites may be central to the maintenance of peace- and state-building processes*”. Assessing the direction of travel is often easier than assessing whether institutions fit certain norms at a given time.

Table 1. General budget support in fragile states (percentage of total ODA)

0	Zimbabwe
0	Somalia
0.4	Yemen
1.4	Eritrea
1.8	Sudan
1.9	Afghanistan
2.4	Nepal
2.9	Congo Rep.
3.2	Timor-Leste
3.2	Ethiopia
3.6	Guinea
4.2	Chad
5.6	Haiti
5.8	DRC
8.4	Uganda
8.8	Guinea-Bissau
11.1	Liberia
11.4	Niger
11.5	Cote d'Ivoire
13.6	Burundi
16.3	Sierra Leone
16.4	Rwanda
17.2	CAR

Source: Oxfam, 2011 and OECD, 2012

Box 3. Alternatives to budget support in low-accountability countries

Budget support is only one among a range of aid modalities – including project aid – that can make use of country systems, and therefore strengthen them. The following alternatives to budget support in low-accountability countries can be considered:

- **Multi-donor trust funds (MDTFs):** first, MDTFs can deliver some of the benefits of budget support: increased resources, expenditures and services in priority areas, and improved donor coordination, enabling more collective impact on development outcomes. Second, multi-donor trust funds can disburse into the budget on a reimbursement basis and can use country public finance management and procurement systems, strengthening them while at the same time providing a greater level of comfort than budget support. The Myanmar three-disease fund, created in 2006, and the multi-donor ZimFund in Zimbabwe, set up in 2010, demonstrate the benefits of such an approach. Third, multi-donor trust funds can be designed in ways that strengthen domestic accountability (*e.g.* the post-tsunami, post-war trust fund in Aceh, Indonesia), although this objective is not always built in (*e.g.* Oxfam (2011) finds that in Afghanistan there has been “no apparent effort to strengthen or create lines of domestic accountability for spending within the [multi-donor trust fund] recurrent costs window”).
- **Other modalities mirroring national systems** can be helpful alternatives to budget support, as they can enable actual alignment as soon as conditions allow. They are most beneficial when they build in room for dialogue with government and plans for gradual empowerment. The health sector group in DRC (early 2000s) is an example of such a gradual approach: from a donor coordination group on health issues, it grew into a coordination group formally chaired and later substantially led by the Ministry of Health.
- **Community-driven development (CDD)** is an innovative way to build governance from the bottom up and the CDD experience in crisis-affected Indonesia (1998-2009) is a largely positive example in which improving governance at the district level paved the way for the democratic transition at the central level. But it is resource-intensive and politically sensitive and is only suited to countries where there is a groundswell demanding good governance from the grassroots, or risk leading to tensions between subnational authorities and the national government and therefore undermining the state-building process.
- **Innovative approaches** exist to ringfence aid for public goods, promoting domestic accountability while limiting the scope for aid capture (Collier, 2005). These include direct service delivery that rest on participatory approaches, for example direct service delivery based on community consultations in Zimbabwe (European Union from 2007).

A Transformative Potential to Realise

In “weak but willing” countries, budget support is an attractive investment on the basis of both needs and performance—even more so than in more stable countries. First, fragile states are where the needs are greatest, whether it is needs in terms of macroeconomic stabilisation and what it means for ordinary citizens having had to factor in hyperinflation for years (DRC case study, Oxfam, 2011); needs in terms of service delivery in priority areas such as health and education, when whole generations have been lost to preventable diseases such as polio and malaria and to basic education (Mali case study, OECD 2011); needs in terms of national capacity to agree priorities across society and across government ministries; and of domestic accountability when ordinary citizens have been voiceless. Second, fragile states are where the biggest gains are to be found, given how far behind they are lagging in terms of MDGs or economic performance. According to eleven case studies (IDD and Associates, 2006; ODI, 2010; OECD 2011; Oxfam, 2011), the benefits of budget support in “weak but willing” fragile states are overall clear: by using country systems donors strengthen them; partner government ministries and agencies compete to be a credible alternative to parallel systems; the budget as the main process to negotiate, fund and report back on national priorities is strengthened.

Yet, the benefits of budget support differ across fragile states, as the same case studies show.

Overall, the practice of budget support in fragile states tend to under-deliver on three fronts, capacity development, domestic accountability, and the policy dialogue:

- On capacity development, “*technical assistance/capacity building has been the least well integrated input*” of partnership budget support (IDD and Associates 2006).
- According to the case studies, donors are understandably torn between the wish to make a genuine contribution to national ownership, capacity and accountability, and the reluctance to relinquish control, especially when the poverty reduction and social cohesion agenda of government is less than clear and there is pressure from domestic constituencies for quick and tangible results. For example, Oxfam (2011) found that in DRC, budget supporters have “*thus far ignored the accountability strengthening dimension... This need not be the case even with the emergency or transitional budget support*”, while in Afghanistan “*state-society relations are regarded as the biggest missing link in the reconstruction process*” (OECD, 2011b).
- As for the policy dialogue that budget support is supposed to enable, evaluations find poor coordination among donors and muddled messages to government nearly everywhere. Hayman (2010) finds that in Ethiopia, Uganda, Nicaragua, Honduras and Rwanda, “*decisions [to suspend budget support] have primarily been made on a unilateral basis, with limited recorded dialogue with the government*”, thereby forfeiting the main privilege that budget support offers. “*The political dialogue (in Burundi) has not been particularly effective, partly because donors seem to have been inconsistent and poorly coordinated*” (Oxfam, 2011). “*The rules of the game are not yet clear in relation to what donors would do in case the political situation (in Ethiopia) becomes ‘unacceptable’ again. There does not seem to be an example of a country in which these rules have been fully clarified*” (Oxfam, 2011). Moreover, there is evidence that general budget support is almost always interpreted by the general public as a show of support (or disavowal) to government (Sierra Leone: author’s interviews; Burundi: Oxfam, 2011). This is particularly obvious in fragile states, which combine poor access to information, divided societies and political instability. Budget supporters in Sierra Leone themselves recognise that the decision to suspend budget support, based on technical considerations, translated into political repercussions that they did not fully anticipate. Generally, “*the political context has tended to be less well analysed and adapted to than other elements of the context*” (IDD and Associates, 2006)—when it should be the starting point for any engagement aimed at systemic change.

Moreover, there is a need for future evaluations to examine, beyond discrete contributions to domestic accountability and capacity, whether current budget support practice promotes statebuilding and peacebuilding, as called for in the *New Deal for Engagement in Fragile States*. If the goal of international engagement in fragile states is to promote state capacity, state legitimacy and peacebuilding, then the main question regarding budget support should be: is current budget support practice geared at tackling the causes of fragility and extreme poverty (*e.g.* weak state-society relations; weak elite political settlements; weak social cohesion) and not just its symptoms (*e.g.* poor service delivery; poor MDG performance; recurrent violence)? Or is its principal effect to aid regimes presiding over exclusionary institutions, without stimulating institutional reform? The 2011 UK technical note on DFID’s “strengthened approach to budget support” specifies that the partner government’s commitment to improving domestic accountability will be assessed separately before budget support is authorised, and includes a commitment to spend the equivalent of 5% of budget support on promoting domestic accountability regarding the use of public resources, including aid. In fragile settings, budget support is renamed “statebuilding grants”. The 2012 EU guidance on budget support also shows a bold focus on transformative effects, its goals being, beyond (i) financial management and macroeconomic stability and (ii) improved sector delivery, (iii) promoting human rights and democratic values; (iv) statebuilding in fragile states, and (v) improving domestic revenue mobilisation (European Commission, 2012). Besides the budget process, domestic revenue mobilisation is an important way to strengthen the social contract: taxpayers are usually more

interested in holding government to account; domestic revenues allows for service delivery that contributes to government legitimacy.

What would realise the rewards of budget support—from the short-term effects to long-term institutional transformation, while managing the risks? The recommendations below are drawn from the existing literature, including case studies.

1. **Don't expect short-term results.** If the main objective is expanded or improved service delivery in the short run, budget support in fragile states is probably not the best instrument to use: in life-saving emergencies, for example, direct service delivery would be more practical, with provisions to place it under the partner government's relevant policies and coordination, when they emerge. Evaluations so far cannot trace cause-and-effect relations between budget support and poverty reduction, because budget support is about systemic impact (stronger country systems; better accountability and inclusion) that should eventually, rather than directly, lead to development and resilience. Correlations, however, should be monitored closely in the medium term.
2. **Focus on transformative effects in the medium term, addressing fragility.** Donors should only provide budget support in fragile states if they are ready to stay engaged over the medium term, have a clear idea of how budget support can support inclusion and accountability, and make an investment, proportionate to the volume of budget support, in capacity development (executive functions of the state, audit institutions and civil society) and domestic accountability. Donors should design and provide budget support in ways that tackling the causes of fragility and extreme poverty and incentivize inclusive institutions rather than limit themselves to funding non-controversial policies that would be funded by the government budget anyway.
3. **Don't try anything in isolation.** First, in fragile states national government ownership cannot be equated with national ownership and donors should systematically take a multistakeholder approach. To go with the grain of statebuilding and to have a legitimate basis for transformative budget support, donors must work in support of goals promoted by a critical mass of local stakeholders, organised politically. Second, to have any transformative impact, there is need for a agreement on policy goals among a critical mass of donors, whether budget supporters or not, given that budget support is only one, limited if impactful, instrument of international engagement.
4. **Manage signals clearly for a constructive policy dialogue.** Variation in the modalities of aid, and particularly budget support, can be powerful as long as the messages are not muddled. Coordination (i) among donors—and not only budget supporters—is a prerequisite to any scale-up, scale-down or suspension (*e.g.* what signal will it send to government and other constituencies, what possible side-effects can it have, and how will it affect future policy dialogue?), and (ii) with government (*e.g.* is government willing to remedy the events that caused it, and is it proposing a process that is credible?). “*Any EU response to a significant/serious deterioration in the situation of fundamental value should be progressive and proportionate*” (European Commission, 2012). Such a progressive and proportionate response could also reduce the volatility of budget support, which undermines government planning.
5. **Manage risks proactively.** First, being in reactive mode results in volatility and is usually not conducive to sustaining constructive policy dialogue and therefore delivering transformative impact. Earmarking, tracing, reimbursement modalities and balance of support can help manage fiduciary risk, and a graduated rather than all-or-nothing response can help manage political risk. Second, fragile states more than other countries need a partnership approach. Waiting for conditions to be met, whether political or technical, wrongly assumes that the right incentives are in place for the right people and misses the whole point of budget support, which is to move the goalposts. Moreover, not engaging also carries risks and costs.

6. **Take a dynamic, portfolio approach.** In fragile states more than anywhere else a system-wide analysis and a system-wide approach are needed. Budget support can be the most transformative aid modality in promising fragile states, but is unlikely to deliver any results if other aid modalities (e.g. multi-donor trust funds, which can be designed to strengthen domestic accountability; off-budget sector funds; project aid; dual-turnkey arrangements; community-driven development), and forms of international engagement (e.g. diplomacy, security) work against statebuilding and social cohesion—especially if it is a modest share of the financial resource envelope. Among forms of budget support, there is also merit in mixing general budget support and sector budget support. While sector budget support is less conducive than general budget support to stimulating negotiation across partner government ministries and agreeing strategic priorities, moving away from general budget support to sector budget support may send signals for government to focus on what is most important, while still demonstrating a willingness to assist in sectors where the needs are most urgent. Conversely, a move from sector to general support can signal support and improve development effectiveness.
7. **Don't forget social cohesion.** Whereas the New Deal promotes peacebuilding and statebuilding, the European Commission (2012), AFDB-World Bank (2011) and DfID (2011) place a square emphasis on statebuilding—the capacity and accountability of the state. Social cohesion—or in post-conflict settings, peacebuilding—are an important dimension of resilience that budget support can be instrumental in promoting, for example by ensuring that it does not always “rain in the same place first”, or that the same social groups are always favoured at the expense of others (Sommers, 2005). Social cohesion can be promoted through social inclusion, social capital (“trust”), and social mobility.

Conclusion: The Coming Third Generation of Budget Support

What leverage does budget support really buy? The record of simple budget support, focused on the transfer of funds and on public financial management functions, and of the current model of partnership budget support is that they have not delivered much by way of the key goals of statebuilding and social cohesion. To the question of how budget support affects the elites in fragile states, what do they stand to gain from budget support and lose from its suspension, the honest answer is probably: not much, especially when donors use budget support as a blunt instrument (all or nothing), shy from using policy dialogue beyond agreement on technical milestones, and coordinate poorly with other instruments.

The next few years should be exciting for fragile states watchers and budget support experts: first, because budget supporters are all taking stock of the lessons learned so far and revisiting their approach; second because the primary drivers of budget support, the EC and UK, have already revisited their approach and their new model, a third generation of budget support, is both more ambitious and more stringent. The pressure is up to get systemic change out of budget support, now an explicit objective, and there is less appetite for leaps of faith and vague objectives: now may be the time for budget support to reveal its underlying theory of change—that it can incentivise accountability and inclusion—which is yet to be verified. If main budget supporters are serious about setting the bar higher, as they seem to be, then budget support can empower ordinary citizens to hold their government to account and fulfil its promise of transformation.

Another development is the shift of many fragile states to middle-income status—eleven fragile states, including some populous giants, have already graduated to middle-income status between 2001 and 2009: Georgia (2003), Angola (2004), Cameroon (2005), Republic of Congo (2005), Sudan (2007), Timor-Leste (2007), Cote d'Ivoire (2008), Nigeria (2008), Pakistan (2008), the Solomon Islands (2008), and Yemen (2009). In addition to low-accountability countries, it is possible that middle-income fragile states such as Angola, Cameroon, Iran, Nigeria, Pakistan, Sri Lanka or Sudan, are another category of countries for which budget support may not deliver the transformative results

expected beyond macroeconomic stability and the short-term results of increased expenditures and services for priority areas. Middle-income fragile states tend to have low aid dependency, generally with ODA/GNI ratios below 3%, making aid modalities rather trivial for the partner government, which can switch aid with other funds to meet its priorities. For example, ODA represents 2.2% of Sudan's GNI, of which 1.8% is provided as general budget support, or less than 0.04% of its GNI. On the other hand, because aid represents such a small part of the resource equation, providing aid as budget support may be an effective way for donors to maintain policy dialogue.⁴ Moreover, middle-income fragile states that don't really need the aid money can value the dialogue and knowledge that come with budget support.

⁴ For example, ODA represents 3.9% of Cote d'Ivoire's GNI, and 11% is provided as general budget support. The stated objective of budget support is, among others, to "further dialogue and more effective policies on implemented by the government on reforms in governance, security, development and the economic and budgetary matters and on issues specifically related to the fragility of Côte d'Ivoire" (EU).

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