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NOTE

from : Presidency
to : Council

Subject : Democratic Governance / Policy Dialogue

Democratic Governance is high on the agenda of the Czech Presidency.

At their informal meeting in Prague in January 2009 Development ministers had a rich discussion on democratic governance. Council Conclusions on Support to Democratic Governance - Towards an Enhanced EU Framework Development have been prepared and the Council will be invited to adopt them as an A item on the agenda of its meeting on 18-19 May 2009.

In this context Development ministers will have an orientation debate on "Democratic Governance and Policy Dialogue" at the GAERC meeting. An issues paper on this subject has been prepared by the Netherlands. It is set out in the Annex to this note.

Strengthening Policy Dialogue in EU/Commission Aid Relations with Developing Countries
Issues Paper prepared by the Netherlands for GAERC/Development 18-19 May 2009

Summary

Preferred official aid practices – in particular budget support – build on partner countries' budget systems and institutions to support locally owned poverty reduction strategies. The record so far points to positive results, in particular improved social services (education, health) and transparency in public finance management. In line with recommendations on aid effectiveness (European Consensus, Paris 2005, Accra 2008), both the Commission and EU Member States are increasing this type of aid. Under EDF 10, budget support is scheduled to reach nearly 50% of country programmes, i.e. around EUR 5.5 billion, over the 2008-2013 period.

While any aid modality – including project aid in particular – entails risks, budget support brings specific challenges for donors. These include responding to political changes in partner countries, and to weak governance, occasional incidences of corruption, questionable expenditure and so on. In addition, donors sometimes encounter problems in convincing their constituencies at home of the appropriateness of budget support for specific governments.

The Commission and Member States should recognise these challenges and develop a common understanding on how they could be addressed. In this regard, it is crucial that the in-country policy dialogue (on budget support, governance action plans, article 8 of the Cotonou Agreement, etc) should be exploited to the full in raising issues of concern and agreeing measures in-country with the recipient government.

The importance of a strengthened and coordinated policy dialogue has recently gained attention in the EU development policy, including in the framework of support to democratic governance in developing countries¹. This paper suggests ways in which the Commission and Member States could move forward on these issues.

Expanding EU budget support

In official development assistance, local ownership of development programmes is increasingly recognised as an important prerequisite for achieving sustainable results. In particular, the focus is now on the recipient country's own budget process as the central institutional framework for channelling resources and for holding governments accountable. Budget support, a preferred aid modality when circumstances permit, has resulted in harmonisation of donor policies and alignment with recipient countries' systems and institutions in support of national poverty strategies. This can bring important benefits. In key social sectors such as education and health, service delivery has expanded significantly,² while transparency and accountability in public finance management have improved. What is more, on-budget support and the requirements for increased transparency can make it easier for parliaments to have oversight of revenue and expenditure. This is not the case with project aid.

¹ See the Informal Meeting of EU Development Ministers (30-31 January 2009, Prague) and the Council Conclusions (doc 9047/09) prepared on the basis of the Commission's review of the Governance Initiative (SEC(2009) 58 final).

² See Joint Evaluation of General Budget Support 1994-2004. IDD, Birmingham 2006.

Over the past decade, EU donors have taken the lead in bringing about this gradual change of focus in official development assistance, by both developing this approach with partner countries and influencing the outcomes of the Paris 2005 and Accra 2008 conferences on aid effectiveness. An increasing number of EU Member States provide a large part of their bilateral aid in the form of budget support. In a country like Mozambique for instance, 13 Member States (Austria, Belgium, Denmark, Estonia, Finland, France, Germany, Ireland, Italy, the Netherlands, Portugal, Sweden and the United Kingdom) with the Commission and five other donors (the World Bank, Canada, Norway, Switzerland, AfDB) provide USD 455 million annually for the national budget, working closely together in the process. In line with the European Consensus on Development, the Commission has also expanded budget support very substantially over the past few years. Under EDF 10, the Commission aims to increase budget support, both general and sectoral, to nearly 50% of programmable funds in ACP countries (EUR 5.5 billion, 25% of available funding under EDF 10). For seven African countries this will be in the form of innovative MDG contracts, i.e. contractual general budget support amounting to EUR 1.5 billion over a 6-year period, to facilitate medium-term investments in achieving the MDGs. The EDF 10 programming process also included a Governance Incentive Tranche, which encouraged ACP governments to prepare Governance Action Plans. Based on the quality of their response and other criteria, the Commission has awarded additional funds that will be allocated in line with the priorities identified in the Country Strategy Paper.

Not a blank cheque

Although budget support is not earmarked for specific expenditures, it is never without conditions: it is not a blank cheque. The continuation of budget support payments basically depends on progress by the recipient government in implementing the national poverty reduction strategy. While the entire range of government activities can be part of the dialogue, specific performance criteria are jointly agreed by the budget support donors and the recipient government in a Performance Assessment Framework (PAF). The framework can contain progress indicators ranging from specific tax reforms, changes in central bank supervision and number of persons with access to micro credits, to kilometres of improved rural roads and the percentage of girls enrolled in school³. A Memorandum of Understanding (MoU) between the budget support donors and the government lists the objectives, commitments and responsibilities of all parties for the whole undertaking. Generally, the MoU also refers to broader underlying principles that need to be upheld for the provision of budget support to be continued. These principles cover broader governance issues, ranging from commitment to peace, democracy and human rights, to pursuing sound macroeconomic policies, the independence of the judiciary and the fight against corruption. This implies that in the policy dialogue on budget support there is a broad range of subjects that could potentially be raised by donors, in response to developments in the partner country concerned.

Policy dialogue

An intensive policy dialogue between donors and recipient government is a central element of this type of aid relationship. Both EU and non-EU budget support donors often work closely together on this. The specific dialogue process varies from country to country. Generally, annual reviews are held to jointly assess what has been achieved in the various sectors and on the PAF indicators (see "Not a blank cheque") and what is the outlook for the coming year in terms of implementing the national poverty reduction strategy. Increasingly, local civil society organisations are invited to join the process, although further progress should be made on this. Conclusions and critical issues are agreed in a review document drafted jointly by the recipient government and the donors. In terms of

³ Some donors, including the Commission, distinguish between fixed and variable tranches; in the case of Commission aid, result-oriented indicators, mostly in the area of health and education, have to be fulfilled in order to trigger the release of the variable part of the funding.

timing, the concluding stage of the review is often harmonised with the government's own budget cycle, to make support more predictable.

In addition to the policy dialogue linked to the provision of budget support, the EU and the ACP countries can use the article 8 political dialogue under the Cotonou Agreement to raise broader issues, in particular matters of a political nature. The relationship between the various forums for dialogue differs from country to country. In Rwanda for instance, the current group of budget support donors are, with the exception of the World Bank, all EU donors. This has led them largely to combine article 8 dialogue with the budget support dialogue. The two are separate in most other countries where there is usually a larger non-EU donor group. In Tanzania for instance (with six non-EU countries in the group of 14 budget donors working closely together), the article 8 dialogue takes place only occasionally to cover specific political issues such as foreign policy and internal political developments or issues for which a specific EU angle is relevant. However, many broader issues – mostly related to economic governance – are currently an integral part of the budget support dialogue that generally includes both EU and non-EU donors.

Specific challenges

'Budget support is controversial', wrote Commissioner Louis Michel in a recent publication underpinning the Commission's clear choice to increase this type of support.⁴ Indeed, using the recipient country's own budget process and institutions as the channel for aid is not a feasible option in all developing countries. And even in the case of recipient governments with a good reputation, building on local budget systems and institutions can be a challenge. The state systems in the countries concerned are generally weak. Bureaucracy can limit the impact of funding and reforms on citizens. Corruption cannot be fully excluded, nor can government spending for purposes that would never be on donors' priority lists (the new presidential jet, for example).

Related to this, the dynamics of the public and political development aid debate in donor countries can be a complicating factor. A particular challenge is the difficulty of attributing specific results to the tax payers' euros when budget support is provided. Clearly, more work needs to be done on analysing and documenting the impact. In addition, political developments in developing countries that receive budget support tend to trigger close scrutiny in political debates in donor countries; providing substantial sums of money to fund another government's budget is sometimes seen as taking a measure of responsibility for all its policies.

Recognising these challenges does not imply that budget support should not be the preferred aid modality wherever it is feasible. Indeed, budget support is not inherently more risky than other aid modalities, in particular project aid. What is important is to address these specific challenges properly.

Moving the debate forward

Commission and Member States should find common ground in addressing the challenges that surround budget support. This is even more pressing in view of the current expansion of Commission and Member State budget support operations, providing this type of aid in more developing countries and in greater volumes.

A common understanding is specifically needed with regard to the provision of budget support by the Commission, which is regarded as a joint EU effort in the Member States. For the public and political debate at home it is important that EU Member States and the Commission take a similar approach in the handling of sensitive decisions concerning budget support.

⁴ Budget support: A question of mutual trust. European Commission, 2008.

Discussing these issues in an EU context should, however, not lead to EU donors ‘ganging up’ in existing broader budget support groups in partner countries. The purpose of further debate within the EU would not necessarily be to develop a specific EU angle, but to ensure that important budget support donors have answers to relevant questions.

The following issues could be considered to move this debate forward.

- **Deepen policy dialogue.** It is crucial that the in-country policy dialogue between donors and the recipient government should be fully exploited. The policy dialogue is the key vehicle for donors to exert influence, discuss proper spending of taxpayers’ money, raise issues of broader concern and agree measures and steps with the recipient government. Recent experience, like the handling of a serious corruption case in the central bank of Tanzania, shows that joint action by budget support donors can indeed trigger an effective response by the partner government.
- **Use underlying principles.** The underlying principles in the MoUs that accompany budget support can be a useful starting point for in-depth debate about the broader policies of the partner country concerned. They can provide a reference point for decisions if political developments threaten to breach them. When renewing MoUs it would be important to make the underlying principles as tangible as possible to ensure meaningful dialogue.
- **Consider ministerial level participation.** The in-country policy dialogue generally entails high-ranking officials of donor countries discussing issues with ministers of the partner country. To underline the importance of the dialogue and its outcomes, ministers of donor countries could consider occasionally joining the dialogue, on the basis of an agreed pre-established position.
- **Define relationship between budget support and article 8 dialogues.** As broader issues, like governance, corruption and human rights, may already be part of the budget support dialogue (based on underlying principles of the MoUs), there is a need to clarify the relation with the ‘political’ article 8 dialogue.
- **Harmonise sensitive Commission/EU decisions.** Decisions regarding the Commission’s provision of budget support should have a broad base within the EU, in particular when they are taken in response to political developments and irregularities that could cast doubt on whether budget support, or its continuation, is appropriate in a specific country. Such decisions could be prepared both in-country (EU HoMs) and in Brussels (ACP Working Group) for individual cases of particular relevance and on specific request by a Member State or by the Commission. EU Member States and the Commission should also continue to build on the good experience in taking coordinated decisions concerning eligibility for budget support and its continuation or discontinuation in a specific country.
- **Document results and impact.** A collective effort should be made to analyse and document the results of budget support and its impact on the populations of the recipient countries, as well as its importance for governance. Commission and Member States could work together to take this forward quickly.
- **Regularly discuss progress in GAERC.** The results of EU aid efforts are hardly ever discussed in the GAERC/Development. In view of the importance of maintaining public and political support, future presidencies could consider including progress with and results and

impact of EU aid – and budget support in particular – as a regular item on the agenda of the GAERC/Development. The Commission could provide input for such a debate.

Questions for debate

- While respecting the Paris and Accra principles of aid effectiveness, do ministers recognise the challenges described above when building aid efforts on partner countries' own budgets and institutions? What points in particular?
 - Do ministers agree that an intensive policy dialogue between donors and the recipient government is a crucial element of modern aid relations and a key vehicle for donors to ensure results and accountability when providing on-budget support?
 - Which EU/EC instruments could be used to strengthen such a policy dialogue? How do ministers view the relationship between the article 8 political dialogue and the current broad dialogue that accompanies budget support?
 - What do ministers think of the above suggestions for strengthening policy dialogue and improving feedback on results in the EU context? Are there other options to be considered?
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