The rise and demise of European budget support: political economy of collective European Union donor action

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This article uses the example of European budget support to show the differences in applying principal–agent and collective action analysis to the donor–recipient relationship and the incentives of European donors. Our results show that the Paris Declaration, while formulating the ‘right’ principles, carries a number of assumptions regarding the (cap)ability of donors to act collectively. This assumption, however, fails to include the political economy of European donors and their own political, institutional and individual incentives that undermined this capability substantially. In other words, the domestic political costs and incentives for European donors to implement the Paris agenda, and in particular aid modalities such as budget support, were not given enough consideration when the aid effectiveness agenda was formulated.

Key words: European development policy, budget support, collective action, principal–agent theory

1 Introduction

Poor aid performance tends to be explained in terms of principal–agent problems between donors and recipients of aid, whose preferences over how to use aid resources and achieve development objectives typically diverge. The Paris Declaration on Aid Effectiveness (2005) had the objective to overcome this problem of preference heterogeneity between donors and recipients as well as among donors by means of new aid delivery principles, in particular the principles of ‘ownership’, ‘alignment’ and ‘harmonization’.

This article argues that in doing so, the Paris agenda attempted to provide what can be considered ‘a technical fix’ to the problem of preference heterogeneity. By formulating principles at an outcome level, however, the Paris Declaration ignored the deeper-rooted political processes that lead to diverging preferences and interests among donors, which in turn undermine collective donor action in the

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interest of effective aid. The article uses the example of General Budget Support (GBS) to illustrate this for the case of European donors.

GBS was considered by many the aid vehicle that would best enable the realization of the Paris Declaration on Aid Effectiveness. With its emphasis on respecting recipient ownership, alignment and harmonization, it was expected to overcome the typical principal–agent problems relating to preference alignment, information asymmetry and ‘agency slippage’. How? First, GBS transfers aid resources directly to the recipient government’s budget and is thus spent the same way as resources from domestic revenue, but without creating parallel systems in the way traditional project aid does. As a joint financing mechanism, GBS was expected to improve donor harmonization by pooling resources, holding joint policy dialogues with recipient governments and jointly agreeing on key reform objectives (de Renzio et al., 2005; Cordella and Dell’Ariccia, 2007).

European donors including the European Commission (EC) soon became front-runners in the Paris-based aid effectiveness agenda and – unlike other OECD/DAC donors such as Japan or the United States – the use of GBS. The 2005 European Consensus on Development declared that the European Union (EU) aimed to take a lead role in implementing the Paris principles, and for this purpose intended to increase the percentage of financial assistance provided as GBS (see European Parliament et al., 2005: 3). Given its own nature as a regional integration project it seemed only logical that the EU should be capable of driving the harmonization agenda and implementing GBS jointly. Recognising this role, the EU highlighted in its 2007 ‘Code of Conduct on Complementarity and Division of Labour’ that the EU should act as a driving force for complementarity and division of labour within the international harmonization and alignment process.

The experience with GBS over the last decade, however, clearly shows that the EU and its member states did not live up to their own stated ambitions. In the past years, support for GBS has diminished significantly among European member states. Some member states – for example the United Kingdom (UK), Germany and Sweden – reduced their GBS operations, while others such as the Netherlands (formerly a dedicated supporter and provider of GBS) fully abandoned the modality and ended the provision of GBS in all partner countries. In addition, EU member states not only reformed their own domestic GBS policies but also actively lobbied the EC to reform its budget support policy and to provide GBS more selectively with a stronger focus on political governance criteria (Koch and Molenaers, 2015). By 2015, only a few developing countries remained recipients of European GBS, and overall amounts provided as budget support have decreased significantly. This trend in Europe to withdraw from budget support comes despite evidence produced in several evaluations that showed that budget support worked fairly well and produced envisaged development results such as higher public spending in social sectors, increased discretionary expenditure, allocative efficiency in national budgets and reform of public financial management systems (Faust et al., 2012; Lawson, 2014).

How can we explain this rise and fall of GBS in Europe? A first, perhaps intuitive, explanation would consider a possible deterioration of the governance

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situation in receiving countries. It could be argued that particularly in a number of African countries a series of events such as corruption scandals, electoral fraud and conflicts have made the provision of GBS difficult to sustain for European donors. Though partly true, in this article, we mainly dig into to the dynamics on the European donor side, arguing that a lack of collective action within the EU led to a demise of GBS in Europe.

The article first shows how the Paris Declaration principles were formulated in a way to address principal–agent and collective action problems as primarily technical challenges, but failed to incorporate a political perspective on collective donor action for effective aid. We then turn to the evolution of GBS in Europe, and in a fourth part apply a collective action framework to the demise of GBS in Europe. Our conclusions centre on how to best approach principal–agent and collective action problems of aid effectiveness by taking the opposite direction of the Paris Declaration; that is, by focusing on the political constraints underlying the collective action problems among donors first, instead of on the (technical) outcome of harmonized and aligned aid. This implies that political economy analysis undertaken in the analysis of aid effectiveness (and of GBS in particular) needs to take (European) donors into its focus as much as the political and administrative constraints on the recipient side.

2 The Paris Agenda: Technical fixes for political problems?

2.1 Background: Principal–agent and collective action problems in the aid relation

Whether aid is effective in achieving its objectives of promoting economic and social development and reducing poverty in developing countries has been a long-contested question. Despite the controversy on the empirical evidence for the effectiveness of aid (for an overview, see for instance Mekasha & Tarp 2013), it is commonly understood that whether aid is effective in promoting its goals hinges primarily on how aid is used and thus strongly depends on the actions of the various actors in the complex aid relation between donors and recipients of aid. While the empirical discussion continues, the debate on aid effectiveness has in the meantime moved on to frame the question of aid effectiveness not merely as an empirical, but rather as a (theoretical) political economy problem.

In this vein, government-to-government aid is commonly framed as a principal–agent relation between a recipient government as the agent; and multiple donors as the (collective) principal. From this perspective, the (in)effectiveness of development aid hinges on inefficiencies in two political economy dimensions of the aid relation: the principal–agent relation between donors and recipients; and the collective action dimension among donors.

In general, principal–agent relations are characterized by a setting in which a principal delegates a task to an agent over whose actions she has only limited control. Agency problems in this type of setting typically occur when there are (i) diverging interests and preferences between those who commission the tasks
(principals) and those who should perform the tasks (agents) and (ii) when there is asymmetric information between the two parties (Laffont and Martimort, 2002; Pollack, 1997).¹

In the debate on the effectiveness of international aid, the relationship between donors and recipients of development assistance represents a classical principal–agent setting, in which aid donors as principals need to ensure alignment of the agent’s interests with their own as their ideas and preferences about how to achieve socioeconomic development (and how to apply aid resources to this end) may overlap but typically do not fully coincide. Donors (as principals) are generally (but not exclusively) considered to be committed to public good objectives such as poverty reduction and economic development, while relying on (self-interested) recipient governments as agents to achieve these objectives (Azam and Laffont, 2003: 26; Booth, 2012: 9–10; Bodenstein and Furness, 2009).

The ‘traditional’ way for donors to deal with the agency problem of development aid has been to link their aid provision to political and technical conditions and to implement ring-fenced projects (Booth et al., 2006: 196). However, as donors (and recipients) had to learn over the decades, applying externally imposed ex-ante conditions as an attempt to overcome the misalignment of donor and recipient preferences is generally ineffective and compliance is low (Mosley et al., 1991; Killick et al., 1998; Dollar and Svensson, 2000).²

Spending the majority of development aid through ring-fenced projects has no good track record either. Here donors not only maintain responsibility over planning and project design, they also have to invest in costly observation of the agent (Chauvet et al., 2007). Such micro-management of the agent tends to produce high transaction costs, however, as it absorbs large parts of the recipient government’s administrative capacity (Acharya et al., 2006; Roodman, 2006). In addition, empirical analysis of aid interventions has shown that the proliferation and fragmentation of aid projects and institutions not only led to inflation of transaction costs of aid, but also failed to set a coherent incentive system for recipient governments. At the same time, tens of thousands of projects undertaken over the past decades appear to have largely failed to produce

1. For an overview, see for example Paul (2006) or Bigsten et al. (2011).
2. Empirical evidence has shown that developing country governments stuck to their own policy preferences and implemented reforms only when it was in their interests. Donor conditions had little if any impact on that decision. In many cases, recipients even outmanoeuvred donors: ‘the inducement effect of aid has persuaded governments to enter into commitments which they subsequently break’ (Collier et al., 1997: 1401). In addition, donors significantly undermined their own incentive mechanisms by not reacting systematically to non-compliance. In many cases, non-performance has not been met with reduced aid levels or withholding of second and third tranches of aid, leading to no clear link between performance and aid disbursement (Svensson, 2003: 383). The appropriateness of conditions to actually produce developmental results has also been frequently questioned as they represent evolving donor doctrines and partly misguided ideas of how development can be initiated. There has been considerable debate as to whether these conditions (in particular those tied to market liberalisation under structural adjustment programs) promote or hurt economic growth and human development (see Radelet, 2006).
developmental results at a macroeconomic level (Mosley, 1986; Doucouliagos and Paldam, 2009). 3

Accordingly, various strands in the principal–agent literature applied to development policy and institutions focuses not only on getting the incentive structure between principal and agent right, but also on the capability of the principal – or a group of principals, a ‘collective principal’ (Nielson and Tierney, 2003: 244) – to send coherent and consistent messages to the agent (see for example Martens et al., 2002; Howes, 2014). This brings in the second political economy dimension of aid effectiveness, namely the problem of collective action among donors, as donor preferences and concepts over how to achieve socioeconomic development, and also on how to provide aid, typically differ as well. In practice, the heterogeneity of preferences among donors – if not about ultimate developmental goals, then at least about policies and procedures regarding how to achieve these goals – has led to the emergence of the multi-faceted and highly fragmented international aid system that we observe today, in which each bi- or multilateral donor operates its own, often very distinct, development cooperation system. The resulting plethora of strategic perspectives, institutional set-ups and aid instruments makes it difficult for donors to act as one collective principal vis-à-vis aid recipients.

Whittington and Calhoun (1988: 295) analyzed donor-side incentives to coordinate their aid more than 25 years ago and found that the incentive structure of individual donors may render the coordination problem ‘much more intractable than is commonly realized’. Yet, it is only relatively recently that this political economy perspective on the aid system has begun to receive wider attention, for instance in such works as Ostrom et al. (2001), de Renzio et al. (2005) or the seminal ‘The Samaritan’s Dilemma’ by Gibson et al. (2005), which highlight the role of collective action problems for donor coordination and demonstrate that past approaches to the agency challenge of aid did little to remedy the collective action problem among donors.

Given that both policy conditionality and project aid did not solve the principal–agent problems in the donor–recipient relationship, nor the collective action problems manifested in the highly fragmented and uncoordinated aid system in place towards the end of the twentieth century, donors and developing countries entered into discussions on how best to improve the effectiveness of aid, culminating in the 2005 ‘Paris Declaration on Aid Effectiveness’, signed by over 100 countries, including all European member states. A key focus of this aid effectiveness agenda has been to strengthen developing country ownership over their policies and to reduce donor domination in setting priorities and prescribing policy reforms (‘putting the partner in the driver’s seat’) (see Mummert, 2013).

3. The effect of project aid on domestic accountability structures in recipient countries, that is to say the relationship between the state and its citizens, was also often found to be harmful (Moss et al., 2006) as governments had become more accountable to donors than to national accountability institutions such as parliaments, audit institutions and civil society.
2.2 The Paris principles: taking the ‘political’ out of the political economy of aid effectiveness

The Paris Declaration on Aid Effectiveness (together with its follow-up declarations the Accra Agenda for Action and the Busan Partnership for Effective Development Co-operation) represents the most comprehensive framework to date aimed at addressing the issue of aid (in)effectiveness at a global level.

This contribution notwithstanding, the declaration has also drawn substantial criticism, mainly for being a too ‘technical’ document, which formulated rather generic principles at the level of intended outcomes such as ‘alignment’ and ‘harmonization’, while limiting the prescribed actions to implement these principles to mostly procedural commitments. In the following we argue that this technical focus of the Paris Declaration extends to the way it intended to tackle the political economy challenges to aid effectiveness not by solving, but rather by ignoring, them. This, we posit, is what mainly stood in the way of the Paris Declaration’s own efficacy in promoting its objective of more effective aid.

Put simply, one (albeit implicit) guiding idea of the Paris agenda (expressed by the principles of ownership and alignment) was to do away with the problem of diverging preferences between donors and recipients as well as among donors themselves by simply eliminating donor preferences altogether from the aid relation. This was to be done by moving recipients’ preferences centre stage and committing donors to align their aid to these preferences and the resulting priorities. If implemented, the principles of ownership and alignment would thus remove both: the need for donors to incentivize recipients to align their actions to the donors’ preferences by means of conditionality or similar measures; and the need to maintain a fragmented aid system in which donors implement their individual ring-fenced development cooperation to address their individual preferences and priorities.

This approach of the Paris Declaration to simultaneously tackle the principal–agent as well as the collective action dimension of aid effectiveness by discounting donors’ vested interests in operating non-aligned and uncoordinated aid systems, was in essence an attempt to take the ‘political’ out of the political economy of aid. As a result, the political economy challenge of collective donor action for effective aid could thereby also be reduced to the ‘technical’ principle of harmonization, which meant merely that the donors’ varying formal processes and bureaucratic procedures needed to be brought in line in order to reduce the high transaction costs that originated from the large number of donor missions and reporting requirements in the past, and thus ensure a more efficient provision of aid. This approach is

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4. See, for instance, Chandy (2011) or Roberts (2009).
5. This line of thought is most notably reflected in the Poverty Reduction Strategy Papers (PRSPs), launched by the World Bank as part of the Highly Indebted Poor Countries (HIPC) initiative. PRSPs were meant to be domestically developed national development strategies of developing countries used by donors to align their programmes and priorities (Radelet, 2006; Bourguignon and Sundberg, 2007). The HIPC initiative was launched in the late 1990s by the World Bank. The idea was that these countries would get debt relief if they presented a PRSP.
reflected in the procedural formulation of various of the Paris Declaration’s commitments under the principle of harmonization, such as the commitment by donors to ‘work together to reduce the number of separate, and duplicative, missions to partner countries’, or to ‘implement, where feasible, common arrangements at country level for planning, funding (for example joint financial arrangements), disbursement, monitoring, evaluating and reporting to government on donor activities and aid flows’ (OECD/DAC, 2005: 6).

As we shall argue in the remainder of this article, this technical approach to donor harmonization and coordination was, however, based on (implicit) assumptions regarding the (cap)ability of donors to act collectively that ignored important (domestic) political determinants of donors’ inability to harmonize and coordinate. Because of this, rather than eliminating the collective action problem from the aid relation as intended, we argue that this approach of the Paris agenda only served to increase the disincentives for donors to adhere to their own commitments towards harmonization and alignment, and thus to implement the principles of the Paris agenda for more effective aid.

2.3 The Paris agenda’s failure to address the politics of collective donor action

As argued above, the Paris Declaration and its principles were strongly inspired by the need to align interests and incentives in the agency relation between donors and recipients of international aid. Its procedural approach towards agency and collective action problems of aid effectiveness, however, failed to take into account some of the more political starting conditions as well as various implications of implementing this agenda, in particular with regard to the requirement for donors to harmonize, coordinate and act collectively. In fact, the half-hearted implementation of the agenda demonstrates that underlying political drivers of collective action problems on each side of the donor–recipient relationship should be considered equally important factors in explaining the (in)effectiveness of aid as principal–agent problems (Booth, 2012: 10).

In general, collective action problems arise in the context of public goods provision, when various actors benefit collectively from provided goods or services, whereas the costs of providing these goods accrue to individual actors. This creates the incentive for individual actors to ‘free-ride’ on the others’ contributions, which ultimately leads to underprovision of the good from a collective welfare point of view (Mas-Colell et al., 1995: 362).

As another of its ‘technical’ fixes to address both agency and collective action problems in the aid relation simultaneously, the Paris Declaration commits donors to the increased use of so-called programme-based approaches (PBAs) (OECD/DAC, 2011). In contrast to isolated aid projects, joint programme-based approaches aim at producing systemic effects at national level in the recipient country, such as improved public services, better performing institutions, better public financial management and higher spending in social sectors. These systemic effects, in turn, are expected to contribute to countrywide development outcomes, such as poverty
reduction or macroeconomic stability and growth, which are often intangible and become visible only in the medium to long run. However, as opposed to results achieved by individual aid projects that are clearly attributable to a single donor’s input and that can be claimed as ‘private’ success by that donor, such nationwide development outcomes pose an important attribution problem (Lawson and Booth, 2004). Partly as a consequence of this, they mostly represent public goods, creating the incentive for individual donors to free-ride on the achievements, without incurring the financial cost of contributing large sums. Importantly, the greater the number of uncoordinated donors in a country or sector, the more diffuse becomes the responsibility for the success or failure of producing that public good (Bigsten, 2006).

The incentive to free-ride does not only exist with regard to ultimate development outcomes, but also to more direct and intermediate outputs of joint donor approaches. With stand-alone projects, most analytical work or negotiation efforts with recipients are commonly tailored to the specific project and produce very little added value for other donors that may be active, in the same sector. In the case of joint approaches, however, an important part of the collective action problem consists in the fact that most inputs provided by individual donors to a collective operation also represent club or public goods for others. For instance, any investment in analytical capacity or capacity for conducting the political and policy dialogue with the partner government directly benefits all other donors engaged in a coordinated approach. These investments help for example in terms of gaining a better understanding of budget allocations, political bottlenecks or challenges at sector level. And even donors not engaged in joint operations benefit through higher budget allocations or better policies in those sectors where they are active with stand-alone projects. In addition, the collective financial inputs themselves from donors function as a public good for individual donors as well, as they provide these donors with leverage to promote their individual political or sector agendas well beyond what their individual contributions could exert. This possibility of benefiting at no cost from the inputs of other donors creates additional incentives for others to at least partly free-ride on these inputs and limit their contributions to what is necessary to ‘buy a seat at the table’. This allows them to punch well above their weight in terms of political and policy dialogue to promote political (for example good governance) or sector policy objectives.

To make matters worse, not only do the benefits of collaborative aid efforts have a public good element (whereas the costs are mostly private and accrue individually to each donor), additionally, the cost an individual donor incurs when contributing to Paris-style aid is not limited to the provided financial and technical inputs. This is because the often ‘invisible’ or more long-term development results can bear important political costs for the individual donor vis-à-vis their domestic constituencies.

Taken together, this public goods character of Paris-style aid, and the resulting incentives for donors to free-ride on each other’s contributions, means that the principal–agent focus on aid effectiveness does not serve to tackle the political economy challenges that arise in implementing the Paris agenda.
The case of European budget support is a particularly illustrative example of this failure of the Paris agenda to take the politics behind problems of collective donor action sufficiently into account.

3 Empirical case: the rise and fall of budget support in Europe

GBS is considered by many to be the most consequential form of a programme-based approach geared at implementing the principles of the Paris Declaration on more effective aid.6

Initially provided by the World Bank and other multilateral development banks at the end of the 1990s, budget support became popular among European donors soon after, as a direct response to the aid effectiveness agenda outlined above. In the 2005 ‘European Consensus on Development’ that sets out the main guiding principles for EU development policy, it is stated that: The EU will take a lead role in implementing the Paris Declaration commitments on improving aid delivery . . . , that the EU undertakes ‘to channel 50% of government-to-government assistance through country systems, including by increasing the percentage of our assistance provided through budget support or sector-wide approaches’ and that ‘where circumstances permit, the use of general or sectoral budget support should increase as a means to strengthen ownership, support partner’s national accountability and procedures, to finance national poverty reduction strategies (including operating costs of health and education budgets) and to promote sound and transparent management of public finances’ (European Parliament et al., 2005: 3). Compared to other members of the OECD/DAC, such as for example Japan or the United States, the EU and its member states explicitly supported the use and increase of GBS as a means to implement the Paris principles.

Concrete implementation and support for the use of GBS policies, however, differed across Europe with some member states becoming strong, others mild supporters and others (mostly smaller and new member states) not providing GBS at all. In particular, the larger member states and the EC put GBS policies in place at the beginnings of the 2000s and started to disburse increasing amounts of aid through GBS. The EC, for instance, was among the most dedicated supporters among European donors, providing either general or sector budget support in most of its partner countries, officially stating that they consider budget support as ‘the most effective instrument in development’ (EC, 2008: 3). The then Development Commissioner, Louis Michel, issued a policy document on budget support in which

6. Koeberle and Stavreski (2006: 7) describe GBS as an aid instrument with the following characteristics: (i) channelling of donor funds to a partner country using its own allocation, procurement and accounting systems; (ii) support for a recipient country’s own development programmes, typically focusing on growth, poverty reduction, fiscal adjustment and the strengthening of institutions, particularly the budgetary processes; (iii) policy content, performance assessment and an accountability framework that focus on policy measures and benchmarks related to overall budget and policy priorities, as set out in the country’s own poverty reduction strategy and medium-term expenditure framework; (iv) provision at regular intervals, ideally in alignment with the country’s annual budget cycle; and (v) agreement on general budget priorities and expenditures, so that in principle there is no need to earmark funds for specific items.
he declared that: ‘If in future, as the volume of aid increases, we all continue to fund our own micro projects, each with our own requirements, staking our own little claims, we can say goodbye to any aid efficiency agenda. Budget support and more of it is the only answer. For this reason I have decided to increase the proportion of budget support from 20% of our funding to 50%’ (EC, 2008: 4).

The UK’s Department for International Development (DFID) was also an outspoken promoter of budget support. Already in its 2000 White Paper titled ‘Eliminating World Poverty: Making globalization work for the poor’ DFID stated that the ‘UK Government will work with other donors to channel more of our support through developing country budgetary systems . . .’ (DFID, 2000: 98). In the following budget support policy of 2004 budget support is considered ‘the instrument most likely to support improvements in the accountability and capability of the state’ (DFID, 2004: 11). As one of the front-runners of the aid effectiveness agenda, DFID was also among the most progressive European bilateral donors to promote a ‘somewhat radical move away from funding development projects in poor countries towards the direct financing of national development and poverty reduction programmes’ (Porteous, 2005: 283).

Joining DFID and the EC in their support for budget support were also the Netherlands and France. The Netherlands started to grant GBS already in 1998 and scheduled its first policy in the second half of 2002. Generally supportive of the use of budget support, then Development Minister Agnes van Ardenne also linked its use to specific requirements such as the PRSP process, effective policy dialogue on good governance and poverty reduction and measurable results (see Dijkstra et al., 2012). As an indicator of this support, Dutch budget support increased from 59 million euros in 2000 to over 160 million euros in 2007 (ibid.). France also declared its support for the aid effectiveness agenda and stated that it would increase the use of budget support as a consequence (CICID, 2007). Other supporters for GBS included Sweden, Denmark, Finland and Germany even though these countries handled its provision more selectively and included stricter governance criteria and thresholds than other European member states and the European Commission (see Narea and Christensen, 2004; DANIDA, 2009; Ministry for Foreign Affairs of Finland, 2005; BMZ, 2008).

Between 2006 and 2010, during the heyday of GBS in Europe, European member states and the EC spent roughly 15.5 billion euros as GBS. However, despite this considerable overall total, the percentage of GBS of overall country programmable aid of European donors in the same period remained low. Even the most progressive European donors, such as the UK, reached a maximum of no more than 17.8% of overall country programmable aid in the same period.7

Around the year 2008, political problems started to mount in a number of GBS recipient countries (mainly in Africa), including corruption cases, election irregularities, human rights violations and restrictions on political freedom. European donors, however, failed to act collectively in these situations and thus sent incoherent signals to the recipient governments. Usually, each European donor

7. Data obtained from the OECD/DAC CRS databank
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agency reserved its right to unilaterally interpret the situation. In the absence of a ‘neutral’ or harmonized arbitration authority this meant that some donors interpreted political events such as the discovery of large corruption cases as a cause for at least temporarily suspending disbursements, while others interpreted the same event as evidence for improved transparency and oversight and continued or even increased their payments (Faust et al., 2012). And even if donors agreed to use GBS as a sanctioning device, they acted in an uncoordinated manner, with some reinstalling payments soon after, others changing aid modalities away from GBS and some freezing their financial contributions for a longer period of time. The main reason for this failure of collective action can largely be attributed to domestic politics in donor countries, and the fact that decisions were not taken (collectively) at local level, but heavily steered from European headquarters in reaction to media articles, pressure from national parliaments or their own political constituencies (Faust and Koch, 2014; Koch and Molenaers, 2015).

These political problems in recipient countries, however, did not simply trigger short- or long-term GBS suspensions by some European donors, they also led to more support for political conditionality attached to GBS. While several European donors were selective from the beginning with regard to governance criteria (for example Germany and Sweden), others (for example the Netherlands and the UK) increasingly started to attach political conditionality to GBS. As a result, the original aims of GBS, to implement the Paris principles, to provide reliable funding for poverty reduction strategies, to emphasize country ownership and alignment and to improve donor harmonization, were increasingly pushed into the background.

European donors not only started to attach stricter political conditionality to GBS, their overall support for GBS also faded towards the end of the 2000s. In the UK, for instance, a newly elected Conservative government came to power in 2010 and distanced itself from the previous GBS policy: ‘we will not be as willing as Labour have been to give the benefit of the doubt to governments where we are not completely clear about the probity of the audit and accountability systems’ (Conservatives, 2009: 17). Subsequently, in 2011, the new Conservative government announced that it would halve GBS operations by 2014–15 and that, in the future, sector budget support would be preferred over GBS. In Germany, the new liberal Development Minister Niebel (2009–13) publicly declared that his party considered the very idea of budget support to be flawed and the wrong approach in development policy and that no new budget support operation would be established in that legislative period. The same stance has since been taken by Niebel’s successor Gerd Müller, who recently stated that he does not intend to provide German aid as budget support, since he considers GBS to be difficult to control by donors. In the Netherlands, GBS came increasingly under pressure from parliament, the auditors’ office and the independent evaluation office, leading to a more


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restrictive and political use of GBS from 2007 onwards. In 2010, a new government was elected and, also as a result of fiscal austerity, significantly reformed the Dutch approach to development policy in general, and to GBS in particular. This has led to a steep decline in GBS, with incoming ministers ending GBS operations in almost every country (Dijkstra et al., 2012). By 2014 the Netherlands had virtually stopped all GBS operations.

As a consequence of this general trend among European donors, the financial volume provided as GBS by European bilateral donors and the EC fell to 4.2 billion euros between 2011 and 2013, with the EC (2.2 billion) and France (1.1 billion) providing the largest chunk of it.11 Several European member states, however, not only changed their own domestic budget support policies but also actively lobbied the EC to give more weight to political governance concerns when providing GBS. Also, against the background of the Arab Spring which had seen the EC come under fire for having provided GBS to authoritarian and repressive regimes, then Commissioner for Development Andris Piebalgs initiated a reform of the EC’s budget support policy at the end of 2010. In this process, several member states demanded that the EC attach stricter political conditionality to GBS (see Koch and Molenaers, 2015). As a result of this pressure GBS has been reduced drastically by the EC. With the new aid programming period starting in 2013/14 only a dozen GBS recipients remained in the EC’s portfolio, with large amounts of aid now provided as sector budget support (interviews, EC).

This general trend among European donors is all the more surprising given that the EC and various member states have invested substantial efforts in producing empirical evidence for the effectiveness of GBS through a number of large scale joint evaluations at country level (see Faust et al., 2012; Dijkstra et al., 2012; Lawson, 2014). These evaluations provide a fairly favourable picture of the effectiveness of GBS as a financing instrument in support of poverty alleviation and development-friendly policies in recipient countries, but note the failure of European donors to harmonize their approaches to GBS and to act collectively (Lawson, 2014). In other words, the new scepticism among European donors vis-à-vis the provision of GBS would not seem to be justified on empirical grounds.

4 Explaining the demise of European GBS from a collective action perspective

Set against the background of the described shortcomings of traditional project-based aid and the resulting aid effectiveness debate, the widespread withdrawal of European member states from joint budget support programmes poses a politico-economic puzzle: why should European bilateral donors give up an instrument that has the potential to reduce burdensome transaction costs, address some of the most persistent principal–agent impediments to results-oriented and incentive-compatible donor–recipient aid relations, and that is being shown in a growing number of

11. Data obtained from the OECD/DAC CRS databank

country evaluations to be an effective instrument to finance national development and poverty reduction strategies?

Applying a collective action perspective instead of a principal-agent lens to the Paris principles, and particularly to the cost-benefit calculations that influence donor decisions to cooperate or defect in a collective donor exercise helps to explain this puzzle. As already outlined in the Section 2.2, the Paris agenda and GBS as its paradigmatic aid instrument failed to take account of the cost-benefit structures for collective action and, in particular, the domestic political costs of implementing the new principles. Joint donor approaches such as GBS clearly constitute a public good from an altruistic donor perspective. In contrast, the direct cost of providing financial and non-financial inputs (such as analytical capacity, technical assistance or policy dialogue) to GBS programmes accrue to the individual contributing donor. Moreover, since GBS implies that the individual donor has very little direct control over the use of the resources provided, there are also potentially high indirect political costs for the individual donor, for example in the form of perceived fiduciary risks in terms of misappropriation of resources (Hayman, 2011; Molenaers, 2010; 2012). Besides fiduciary risks, there are also the political risks associated with providing GBS to governments which may (at times) resort to undemocratic behaviour and/or violate human rights. The risk for the donor is that GBS provision (unlike projects) is considered to be an overarching endorsement of a recipient country’s regime and its policy choices. These political costs are arguably higher with GBS than with other forms of government-to-government aid, as project aid tends to be perceived as an intervention targeting certain groups of beneficiaries, and hence is supposedly less ‘political’ (Leiderer, 2012).

All the above makes GBS, and thus also the individual donor administration, an ‘easy’ target for criticism (justified or not), particularly by the political opposition in the donor country, implying a potentially substantial political cost for the donor government when providing GBS. These costs for individual European donors, however, were not foreseen or acknowledged in the Paris principles and the EU’s own statements on aid effectiveness.

Importantly, these costs of providing GBS were not shared equally among Europeans. The specific ‘political cost structure’ for each provider of budget support can vary substantially depending on the domestic political situation, the weight and strength of political opposition and veto-players (see Faust and Koch, 2012; Koch and Molenaers, 2015). It would thus seem reasonable to expect that whether a donor agency that – altruistic motives of aid provision not withstanding – relies on its domestic legitimacy for funding and its very existence, decides to give GBS or not, ultimately depends on whether the political credit it can claim for development results achieved through GBS outweighs the political costs of doing so.

The public goods characteristics of outputs and development outcomes achieved with the support of GBS, combined with ‘private’ financial as well as political costs for any individual European donor deciding to contribute to a joint GBS programme, create strong incentives for individual donors to free-ride on other donors’ efforts (Kemp, 1984: 6; Olson, 1971). Unfortunately, to date neither the international aid effectiveness agenda nor independent initiatives among European donors have established any specific normative guidance of how to effectively
counteract these counter-productive collective-action-related incentive structures. As a result, each donor agency faced with the decision whether to provide GBS has to balance the potential rewards from budget support in terms of more effective, but not individually attributable aid with the incentive to free-ride and the individual domestic political cost for donors.

The potential rewards of GBS for European donors, on the other hand, seem to have gradually lost importance while incentives to ‘leave the club’ and to free-ride have grown. First, the aid effectiveness agenda and its strong focus on ownership, alignment and harmonization has been increasingly supplanted by a strong focus on results and ‘value for money’ and thus on measurable and easy to quantify outputs and outcomes that can be directly linked to individual donor activities (see Klingebiel and Janus, 2014). While these ‘results’ (x number of children vaccinated, enrolment increased by x per cent) seem to be easier to communicate to the general public in European member states, they tend to neglect the key principles of the Paris agenda, in particular efforts to better harmonize donor interventions. Leaving concerns for more effective aid largely aside, these direct and attributable development outcomes seem to provide higher ‘private’ benefits for European donors than development outcomes provided through GBS that aim at systemic effects with public goods characteristics.

And also the domestic political costs have changed in most European member states over the last decade. In many member states, governments have changed from left-leaning to conservative (right-wing) governments around the end of the first decade of the twenty-first century. This shift has also altered the political cost structure for GBS. Faust and Koch (2014) show that the provision of budget support among European member states is heavily influenced by government ideology, with right-wing governments being more sceptical of the aid modality. This finding can be explained by the fact that conservative governments are more risk averse and prefer to have control over their aid activities because their constituencies are more sceptical about aid in general and are disproportionately concerned about aid being wasted by corrupt recipients (ibid.). Since GBS is perceived as an endorsement of a given regime, conservative governments consider GBS as a direct support for ‘corrupt regimes’. While GBS might thus be the most consequential aid modality to implement the Paris principles, it causes significant domestic costs for European development ministries and bureaucracies. In the current political climate across Europe, these costs seem to have gradually outweighed the benefits of GBS. Put differently, incentives to free-ride and to focus on forms of foreign aid that are low-risk, easy to attribute and good to sell to domestic constituencies seem bigger than incentives to stick to the Paris principles and concerns to make aid more effective. Across Europe, we now have a situation where the EC remains as more or less the only provider of GBS (albeit with significantly reduced amounts). This widespread withdrawal of member states from GBS could be misinterpreted as a successful case of collective action – in the end there seems to be a trend towards convergence of European bilateral donors in terms of the collective removal of GBS from their aid modality portfolio. Effective collective action for aid effectiveness (and public good provision), however, is not to be confused with collective action motivated by political survival.
5 Conclusion: Implications for the future of EU development policy and the aid effectiveness agenda

Providing foreign aid poses a number of challenges for European donors. As we have shown in this article, most scholars have considered these challenges within the principal–agent framework. In doing so a number of solutions have been proposed, with many of them taken up in the Paris Declaration. We argued that the problems of collective action, in particular among European donors, in the aid chain have been underemphasized. Even though European donors in particular could be expected to subscribe to a deep harmonization agenda of their aid programmes, as they are already part of a regional integration project and have publicly declared their support for the Paris principles and increased harmonization of European aid interventions, they have failed to act collectively. Most often these collective action dilemmas form an impediment to implementing the proposed solutions of the Paris agenda. We have looked at the rise and demise of budget support in Europe as a case in point. Initially welcomed by European donors in particular, GBS was given star billing among aid modalities (at least in discourse), but after a while – despite positive evidence in terms of impact – it was largely abandoned.

In this article we have analyzed both the expected advantages of GBS as a solution to many of the principal–agent problems, while also digging deeper into the collective action requirements incorporated into the proposed solutions. The cost–benefit structure that European donors are confronted with when engaging in GBS in a multi-stakeholder setting have been particularly underanalyzed, yet provide the missing link to a real understanding of why donors seem to be unable do the right thing in terms of aid effectiveness (at least in the current political climate across Europe). We have shown that the public good benefits of the GBS-modality cannot outweigh the privatized political costs and risks of GBS.

Future negotiations on the international aid effectiveness architecture and on the future of EU development policy will have to address the crucial challenge of translating political commitment into behavioural change much more explicitly and effectively than has been the case in the past. This entails both the formulation of standards and norms and the establishment of mechanisms on both sides of the aid relation to make incentives with regard to principles and commitments compatible at a political, institutional and individual level (de Renzio et al., 2005: 8, 17). In order to achieve this, European donors will first and foremost have to devise mechanisms that ensure their own compliance with international and European commitments both at headquarters and at national level. In order to better understand the compliance of European donors with the standards they have set for themselves, it is crucial to get a better understanding of their own political economy and the political and institutional structures in which they operate.

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