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Foreign Aid and the Domestic Politics of European Budget Support

Jörg Faust
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Bonn, July 2014

Jörg Faust and Svea Koch

Abstract

We analyse domestic factors within European donor countries that have influenced their provision of budget support. Budget support has been one of the most promising, and at the same time, controversial aid instruments aimed at improving aid effectiveness as well as donor harmonisation. Based on theoretical considerations, our econometric analysis for the 2002–2012 period shows that government ideology, the economic context in donor countries, as well as the structure of their aid systems have been important determinants of budget support provision. A comparison of Germany and the United Kingdom sustains these findings with qualitative evidence. Our findings also indicate that these ideological, economic and bureaucratic factors have worked as important barriers to improved donor harmonisation within Europe.

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Abbreviations

BMZ	Federal Ministry for Economic Cooperation and Development (Germany)
CDU	Christian Democratic Union
CPA	Country programmable aid
CRS	Creditor Reporting System
CSU	Christlich Demokratische Union (Christian Democratic Union of Germany)
DAC	Development Assistance Committee (OECD)
DCD	Development Cooperation Directorate (OECD)
DED	Deutscher Entwicklungsdienst (Germany)
DFID	Department for International Development (United Kingdom)
DIE	Deutsches Institut für Entwicklungspolitik / German Development Institute
EU	European Union
FDP	Freie Demokratische Partei (Free Democratic Party of Germany)
GBS	General budget support
GDP	Gross domestic product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit (Germany)
GTZ	Deutsche Gesellschaft für technische Zusammenarbeit (Germany)
InWent	Internationale Weiterbildung und Entwicklung (Germany)
KfW	Kreditanstalt für Wiederaufbau (KfW Development Bank)
MP	Member of parliament
NGO	Non-governmental organisation
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OLS	Ordinary least squares
PFM	Public financial management
UK	United Kingdom
UN	United Nations
UP	Underlying principles

Summary

This paper aims to identify the domestic origins of budget support provision in 15 European donors during the 2002–2012 period. Our econometric analysis, supported by two case studies of Germany and the United Kingdom (UK), provides evidence that the provision of budget support was heavily influenced by government ideology, economic circumstances and bureaucratic structures in European donor countries. Our study also contributes to a better understanding of the domestic reasons for the continuing collective action problems in the EU's development policy. It strongly suggests that the approach of decentralised coordination among European donors has not solved the ongoing effectiveness and efficiency problems of European foreign aid. Against this background, we conclude that more binding coordination mechanisms – if not further integration of European aid policies – are key to securing European influence in a changing international landscape.

Budget support has been at the centre of discussions on how to make European aid more effective and also better harmonised. Budget support consists of direct transfers of financial resources to the recipient government's treasury, aims at aligning itself to the recipient country's policy priorities and uses endogenous budget procedures of the recipient. The instrument also has a number of in-built characteristics to better harmonise aid interventions: a joint financing mechanism that comes along with joint political dialogues and performance assessments. Given its design, budget support was thus expected to counter the criticism of traditional project aid, which had increasingly come under fire for producing only meagre development results.

However, this perspective of the potential of budget support was not shared uniformly by European governments and aid bureaucracies. Sceptics quickly denounced it as a “blank cheque to corrupt regimes” and as an instrument that bears high political and fiduciary risks. Some bilateral donor governments were thus more cautious and selective, and highlighted the need to tie budget support to strict political conditionality. Others were strong supporters, and highlighted the potential of budget support to make aid more effective in reducing poverty and refrained from making budget support a political instrument. Thus, European donors had different degrees of risk averseness and different preferences regarding the provision of budget support. These policy differences became particularly apparent in different budget support disbursement and suspension strategies, particularly in times of political crisis in recipient countries. Acting in a non-harmonised way, in turn undermined the collective influence of European donors and led to inconsistent signals being sent to developing country governments. The attempt to use budget support as a catalyst for better harmonising the delivery of European foreign aid thus remained well below its potential.

Against this background, we argue that these different preferences of European bilateral donors towards the provision of budget support and the different degrees of risk averseness have been systematically driven by domestic politics within European donor countries. Our econometric analysis of 15 European donor countries in the 2002–2012 period identifies three main factors that explain the heterogeneity of budget support disbursements:

- First, more conservative governments on a left-right scale of politics have disbursed significantly less budget support. 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 over proportionally concerned about aid being wasted by corrupt recipients.

- Second, the domestic economic context in European donor countries played a significant role in budget support disbursements with lower domestic growth rates having a disproportional negative effect on budget support disbursements. Our explanation for this finding is that during times of economic crisis it is particularly difficult for donor governments to spend aid on less visible and supposedly more risky forms of foreign aid.
- Third, the provision of budget support has been negatively affected by the existence of strong implementing aid agencies relying on a project-based model of aid delivery because such agencies tend to oppose budget support as a threat to their traditional business model. At the same time, aid systems without such structures have found budget support an adequate instrument for decreasing disbursement pressure in time of rising aid volumes.

We supplement our econometric analysis by a qualitative comparative case analysis of Germany (a rather cautious provider of budget support) and the United Kingdom (a strong supporter of budget support). Comparing both cases reveals that the project-based model of aid delivery in Germany created strong barriers against the provision of budget support. In contrast, in the United Kingdom no such opposition existed, which made it easier to disburse increasing amounts of foreign aid as budget support. Moreover, the comparison of both countries clearly reveals how the changes in the party composition of government affected the provision of budget support.

Overall, the heterogeneity of using budget support as an aid instrument has therefore not been randomly distributed among European governments but was rooted in political, economic and bureaucratic interests within European donor countries. As those features vary strongly within and between European donor countries, they present serious barriers to harmonising aid practices in a decentralised way. Against the evidence presented here, it seems questionable whether European donor governments will be able to craft well-harmonised aid interventions in a decentralised manner. In the case of budget support, or what remained of it, delegating more policy and coordination competences to the European Commission to manage a truly European approach to the instrument needs to be the way forward. European governments face a tough choice: either they abstain from their ambition of increasing Europe's collective action capacity towards the developing world; or they start to make serious progress in better harmonising, if not integrating, their bilateral development and foreign policies.

1 Introduction

Since the early 2000s, general budget support (GBS) has become one of the most prominent but also controversial instruments of foreign aid. Initially provided by the World Bank, budget support soon became popular among other multilateral development banks, the European Commission and bilateral European donors.¹ However, despite claims that GBS should develop into donors' preferred aid modality (see DFID 2004; EC 2008), the proportion of budget support has remained modest in relation to the overall aid portfolio of donors. Moreover, one of the expectations of budget support was that it would lead to increased donor harmonisation by pooling resources and coordinating non-financial inputs such as policy dialogue and conditionality (de Renzio et al. 2005). Especially among European donors, however, a great heterogeneity in budget support policies emerged during the 2002–2012 period, with different objectives attached to the instrument, large varieties in amounts and recipients of budget support, and different interpretations regarding the extent to which budget support should go along with political conditionality. This policy heterogeneity, in turn, severely undermined the effectiveness of the instrument and the attempts at improved donor harmonisation (e.g. Faust et al. 2012; Molenaers 2012). Against this background, we investigate the domestic political origins of this heterogeneity and embed our analysis in the current debates around aid effectiveness as well as European development and foreign policy.

From an *aid effectiveness perspective*, budget support for many seemed the most promising aid instrument to implement much-needed reforms for making foreign aid more effective. GBS is intended to directly co-finance anti-poverty policies of a recipient government using the recipient's own budgetary and administrative processes. This approach was expected to strengthen recipients' ownership and minimise the administrative burden associated with the traditional highly fragmented project approach. To cope with the fiduciary risks entailed in the process of directly funding the recipient state's budget, the provision of financial resources has been part of a package of several non-financial components: political and economic conditionality; policy dialogue; as well as capacity-building to strengthen public financial management systems. By using partner country's own administrative systems, accompanied by the non-financial components, budget support is also expected to contribute to institutional reforms (Faust / Leiderer / Schmitt 2012). Even though the in-built characteristics of budget support incentivise donor harmonisation, especially the non-financial inputs require additional coordination efforts on the donor side in order to ensure a predictable flow of funds and a credible set of incentives for the recipient government.

The latter requirement for improved donor harmonisation seemed to be particularly in line with a *European perspective*. In theory, the joint policy dialogue between European bilateral budget support providers (including the European Commission) and the recipient government could have functioned as a catalyst for policy convergence through improving harmonisation and coordination between actors of European development and foreign policy (de Renzio et al. 2005). However, the perception of budget support as an innovative

1 General budget support is different from other forms of budget support such as, for example, sector budget support, where funds are earmarked for specific sectors. In this paper, we focus on the use of GBS, but use the terms GBS and budget support interchangeably.

and effective aid instrument was at the time not shared uniformly by European governments and aid bureaucracies.

Sceptical arguments pointed to the high fiduciary risks and the potential risk of strengthening authoritarian structures and neo-patrimonial politics by directly co-financing the recipient government's budget (see Barkan et al. 2005). As the broader public in donor countries often perceived budget support as an endorsement of the recipient country's political regime, donor governments can be held accountable by their own domestic constituency as a co-financier of corruption or human rights abuses (e.g. Handley 2009). Moreover, budget support provided less visibility in donor countries than purely bilateral development interventions but high visibility in case of suspensions.

As a result of these arguments in favour and against the use of budget support, the degree to which European donor governments engaged in its provision varied strongly. We argue that European governments' preferences for using GBS were not just randomly distributed but were influenced by the domestic political context of member states. These political dynamics, in turn, reveal an important factor that accounted for the slow and hesitant implementation of the aid effectiveness agenda (see Wood et al. 2011). The aid effectiveness principles were erroneously considered a political agreement that required smart technical ways to be fully implemented; they neglected, however, the political economy of aid donors and the domestic political interests and institutional challenges that hindered these principles being endorsed entirely. Budget support and the different preferences of European member states provide a very interesting case to highlight these political economy factors that hindered a more progressive implementation of the aid effectiveness principles.

We expect three factors of the domestic political context of donor countries to have played a key role: i) partisan politics, ii) the economic context and iii) bureaucratic interests. To test these claims, we performed an econometric analysis of 15 European donors in the 2002-2012 period complemented by a small-n comparison of the two largest European donors: Germany and the United Kingdom. Our empirical investigation provides strong support for these arguments. More conservative governments did disburse less budget support, while budget support disbursements were negatively influenced by an unfavourable domestic economic context. Moreover, our econometric analysis also revealed the importance of constant contextual factors at the country level over the period under investigation. We thus performed a case study analysis to, first, trace the impact of partisan politics on the provision of GBS, and, second, to zoom in on the impact of the institutional set-up of a donor country's foreign aid system on its preferences for budget support.

Overall, our analysis contributes to two strands of research. By showing how the economic context and the government composition shape the use of a highly political aid instrument and undermine efforts for better aid harmonisation, we contribute to the debate on how domestic donor politics contribute to limited aid effectiveness. Moreover, our findings also link to the literature on a common European development and foreign policy as they demonstrate how attempts of external policy convergence were undermined by political and bureaucratic considerations of national governments.

The paper is structured as follows: Section 2 starts by sketching the implementation logic of budget support against the background of the aid effectiveness debate. We also introduce recent case-study evidence which shows the limits of European donor

harmonisation in the implementation process of budget support (2.1). Hereafter, we analyse GBS from a political economy perspective and deduce our hypotheses regarding the impact of domestic politics on budget support provision (2.2). In Section 3, we present our econometric analysis (3.1) and our two case studies of Germany and the United Kingdom (3.2). By describing the political processes *within* each country over time, we provide further evidence on how partisan politics have influenced GBS policies. Moreover, by comparing the rather time-invariant bureaucratic structures of both countries, we point to the importance of these structures for policy preferences regarding the use of GBS. The conclusion sums up our results and discusses avenues for further research.

2 Analytical framework

2.1 The rise of budget support and its expected benefits

The rise of budget support at the end of the 1990s has to be understood against the background of the mounting criticism of the traditional aid system and subsequent reform efforts, which culminated in the 2005 Paris Declaration and the 2008 Accra Agenda for Action.² The reform agenda demanded that donors respect recipient countries' ownership of their own policies, align behind these domestic development objectives, use recipient countries' own administrative systems for channelling aid and harmonise their aid interventions (OECD 2008). Moreover, the changes envisaged by the aid effectiveness agenda not only identified *what* should be done differently in the future, but also *how* donors should deliver their aid in order to put the principles into practice.

In this regard, budget support has been considered most apt to implement these *aid effectiveness* principles. According to its design, it promotes harmonisation by pooling donor resources and avoids parallel structures by channelling funds directly into a recipient government's budget. To cope with the fiduciary risks entailed in the process of directly funding the recipient state's budget, the provision of GBS has been accompanied by several non-financial components: political and economic conditionality; policy dialogue; and technical assistance to strengthen public financial management systems. In addition, through its financial and non-financial components, budget support aims at a combination of financial and governance objectives.

The instrument's financial objective mainly consists of providing predictable funding for the implementation of poverty-reduction policies. In addition, the instrument also aims at actively promoting the quality of governance, using the leverage of financial contributions to improve public financial management and more transparent, effective and accountable state institutions (Faust / Leiderer / Schmitt 2012). In its most ambitious interpretation, budget support has also been considered as an instrument for supporting democratic

2 Mounting empirical evidence showed that aid interventions were often too fragmented to establish coherent incentive systems and too numerous and scattered to strengthen domestic administrative structures. Quite the opposite, the vast number of projects often overburdened already weak administrations in developing countries by establishing parallel reporting and management systems. In addition, conditionalities have often imposed policy reforms on countries, while neglecting recipients' own development preferences and strategies (see e.g. Collier et al. 1997; Acharya / De Lima / Moore 2006; Knack / Rahman 2007).

accountability and human rights (Hayman 2011; Faust et al. 2012). Thus seen, besides its function of providing reliable funding for poverty-reduction strategies, budget support has become a potentially powerful instrument for donors to influence domestic political decision-making via political dialogue and conditionality. For the different types of political conditionality attached to budget support, see Box 1.

Box 1: Political conditionalities attached to budget support

Political conditionality can be attached to budget support at different levels. The first level is the **eligibility stage**: Only those countries that can demonstrate a good track record in democratic governance are granted budget support. This *selective* provision of budget support is meant to be “hands-off” and not directly aimed at leveraging improvements in democratic governance. Once a donor and a recipient country agree on the provision of budget support, they integrate **underlying principles** (UPs) into their contractual agreements. These serve as the underlying conditionality for providing budget support and typically include i) macro-economic stability, ii) government commitment to implement a national development and poverty reduction strategy, iii) commitment to implement reforms in the area of public financial management (PFM), and iv) commitment to democratic principles and respect for human rights. If one of these UPs is (considered) violated, donors have the option to schedule a **political dialogue** to openly address these issues. They can also **withhold, delay or suspend** budget support tranches to incentivise domestic political change or to signal their disagreement with the current political situation.

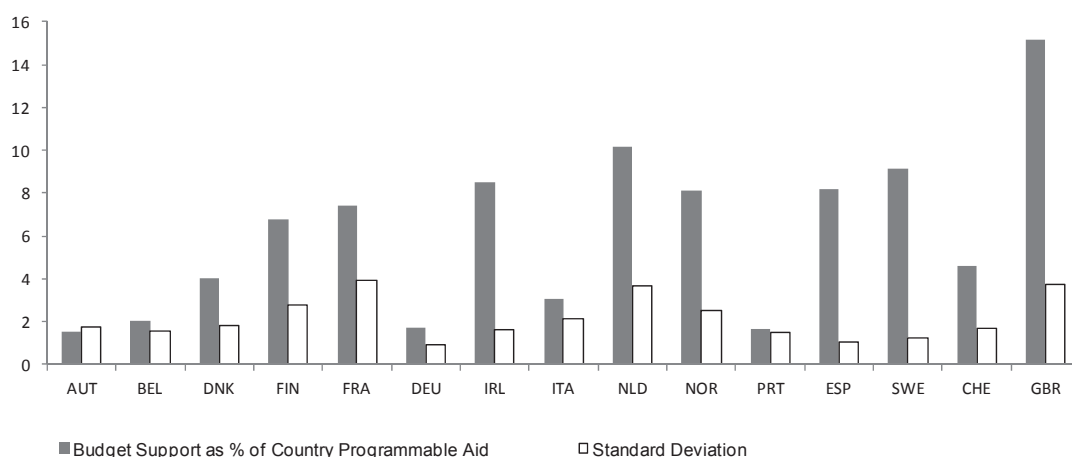
On the positive side, donors hope to provide an incentive for democratic accountability and civic participation by making the budget process more transparent. In addition, donors also aim at supporting key democratic institutions such as supreme audit institutions, political parties, media and civil society organisations with financial and technical assistance in order to minimise their own fiduciary risks.

In addition to having the potential to make aid more effective, budget support could have made a contribution to *a better coordinated European development policy*. Development policy is a shared competency within the European Union (EU) leading to continuous struggles between the European Commission and member states on how to establish a more unified appearance while maintaining national autonomy in policy formulation (Carbone 2008; Orbie / Versluys 2008; Klingebiel / Morazán / Negre 2013). Due to its in-built harmonisation characteristics, budget support was expected to strengthen the coordination and harmonisation of European development policy (de Renzio et al. 2005). Pooling resources instead of relying on individually managed projects, holding joint policy dialogues with recipient governments and jointly agreeing on key reform objectives were expected to provide an adequate framework for a well-coordinated appearance of European aid donors. Budget support – amongst other initiatives the 2007 Code of Conduct on Complementarity and Division of Labour – was thus seen as a means to promote a more coherent European development policy through better coordination and harmonisation.

2.2 Critical perspectives on budget support and the reactions of European donors

Even though budget support provided a number of in-built characteristics to make aid more effective and to increase donor harmonisation, it never became European governments' preferred aid modality (Warrener 2004; ECA 2010; Molenaers 2012). According to the data of the OECD Development Assistance Committee (DAC), the percentage of budget support given by a single bilateral European donor in the 2002-2012 period remained low. Even the strongest bilateral supporter of the instrument within Europe, the United Kingdom, reached a maximum of no more than 15% of overall country programmable aid (see Figure 1). Thus, the considerable overall amount of roughly USD 17 billion disbursed via budget support by the 15 biggest European donors in this period has to be put into perspective as it only represented 7% of their overall country programmable aid. Partly, this moderate use of GBS can be related to the limited absorptive capacity of recipient countries' administrative structures (Warrener 2004). The main reason, however, relates to the high perceived risks associated with the instrument that made budget support a highly contested aid instrument.

Figure 1: Average donor share of GBS in overall country programmable aid, 2002–2012



Source: Author, based on CRS data from the OECD DAC

From a financial accountability perspective, budget support was perceived as coming along with high fiduciary risks, i.e. the risk that aid resources could be used for unintended purposes (Koeberle / Stavrevski 2005; Clist / Isopi / Morrissey 2012). Even though other forms of foreign aid are arguably similarly fungible resources, budget support fungibility is much more apparent since donor funds are merged with recipient government's own budgetary resources and are thus subject to their own national control institutions. The instrument has thus been perceived by many donor governments as bearing higher risks regarding mismanagement and potential fraud than traditional project aid, for instance (Faust / Leiderer / Schmitt 2012). Unlike project aid, the provision of budget support is also considered by some as an endorsement of the recipient country's political regime.

Even if donors provide budget support not only to co-finance poverty reduction but also to strengthen institutional quality, corruption scandals, human rights abuses or rigged elections might still occur – in particular since most developing countries are hybrid regimes with regular political hiccups. In particular in the case of a political crisis, donors have been frequently held accountable for having supported these regimes with direct budgetary support (Barkan et al. 2005; Dijkstra / de Kemp / Bergkamp 2012).

Budget support also posed a number of significant challenges from a donor country's political economy perspective. Especially in times of economic crisis and strained donor budgets, foreign aid faces legitimacy concerns and increasing pressure to show visible developmental results (e.g. Vollmer 2012). Budget support is a particularly tricky instrument in this respect. Individual donor contributions are hardly visible given that resources are pooled with other donors' and domestic resources and failure or success cannot be attributed to a particular donor intervention. Moreover, the developmental results of budget support are fairly long-term and more difficult to communicate to the domestic public compared to the short-term successes of earmarked projects (Fölscher / Bartholomew / Carter 2008).³ Budget support suspensions, on the other hand, are highly visible. If the political situation in an aid-receiving country deteriorates and human rights abuses or mismanagement of public funds become public, the pressure on donors to react increases. Since budget support has also been provided to authoritarian regimes such as Vietnam, Ethiopia or Rwanda and to countries with high levels of corruption, the instrument became most prone to be used for aid suspensions and for showing donor's discontent with the current political situation. Thus, withholding or (partly) suspending budget support has been used widely to, on the one hand, send a clear signal to domestic constituencies that such behaviour will not be tolerated, while on the other hand upholding other aid flows to ensure social service delivery and at least partly aid predictability (e.g. Molenaers / Cepinskas / Jacobs 2010; Molenaers 2012).

As a response to these reputational risks associated with budget support, some bilateral donors started to attach stronger conditionalities to their budget support policies, and became more selective with regard to the minimum requirements a country needs to fulfil in order to receive GBS. Initially, budget support was supposed to promote partner country ownership, to be more "hands-off" than previous financing instruments such as structural adjustment funding and to primarily fund the poverty reduction ambitions of partner countries (Warrener 2004). Given the high fiduciary risks attributed to the instrument, and the concerns in donor countries that budget support would strengthen non-democratic and neopatrimonial structures, this "hands-off" approach was often difficult to sustain. As a consequence, many European bilateral donors attached increasing importance to the governance function of the instrument and were more and more inclined to use political conditionalities on different levels.

3 The empirical evidence of the developmental results related to budget support is at least modestly positive, with country evaluations often showing an increase in pro-poor spending particularly in the health and education sector as well as improved allocative efficiency in national budgets (e.g. IDD and Associates 2006; Faust / Leiderer / Schmitt 2012; Caputo / Kemp / Lawson 2011). Moreover, preliminary results from cross-country studies reveal that budget support has not been associated with crowding out effects of domestic revenue (Knoll 2012) and – at least regarding the World Bank's Poverty Reduction Support Credits – has had a positive impact on aspects of democratic accountability (Limpach / Michaelowa 2011).

Still, these associated risks (and opportunities of) budget support were handled very differently among European bilateral donors. In line with the fact that development policy is a parallel competency among European member states, each European donor reserved the right to draft its own individual budget support policy including its own handling and management of the above mentioned risks. As a result, these policies have differed substantially with regard to how selective budget support has been given, the extent to which budget support has been understood as a mere financing or also as a political instrument, and the extent to which budget support suspensions have been used in times of political crisis. The differences in those policy aspects are linked to a donor government's overall preference for the instrument, which varied strongly among European donors. This is illustrated by the heterogeneity of disbursements shown in Figure 1.

Putting emphasis on the governance function, for instance, expresses donors' caution and sceptical attitude towards the instrument. In a similar vein, those donors who are highly selective and introduce high entry criteria for GBS are also likely to have much lower budget support volumes and disbursements. Those who are less selective and use a dynamic instead of a minimum requirement approach – that is, an emphasis on progress rather than thresholds – are also likely to have higher GBS volumes and thus more support for the instrument. Moreover, attaching political conditionalities to the instrument is mostly related to a protectionist attitude and the attempt to shield GBS from domestic political concerns. These donors are very likely to use budget support as a bargaining chip in the case of a political crisis in recipient countries, whereas those who attach no political conditionality put emphasis on aid predictability and the use of GBS for public service delivery.

These different European donor policies have led to considerable harmonisation problems on the ground.⁴ As European donors have not subscribed to a joint budget support policy and a joint management of political conditionalities, the effectiveness of the instrument and the degree of donor harmonisation in a given country context has been seriously undermined (Faust / Leiderer / Schmitt 2012; Molenaers 2012). A 2009 corruption scandal in the health sector in Zambia is a case in point. When the misappropriation of funds became public, Sweden and the Netherlands suspended their budget support disbursements, while the European Commission decided to release additional funds out of its V-FLEX mechanism, an instrument created to absorb the consequences of the financial crisis. These incoherent reactions were the result of different interpretations of the fraud case: those who suspended budget support regarded it as a sign for deteriorating governance and increasing fiduciary risks. Others read it as a sign of progress and strengthened national control mechanisms, since the detection and subsequent prosecution of the fraud case was initiated by local institutions (Faust/ Leiderer/ Schmitt 2012).

But even when European donors arrived at similar interpretations of a given event, they often did not feel bound to coordinate their reactions. In June 2012, a United Nations (UN)

4 Particularly, empirical evidence on the EU's neighbourhood policy has revealed that donors need to provide strong and credible incentives and highly coordinated interventions for conditionality to be effective (Schimmelfennig / Engert / Knobel 2003; Schimmelfennig / Sedelmeier 2004). In contrast, if a country receives inconsistent signals or is aware of internal disputes or quarrels among the donor institutions, this will clearly undermine the incentives for countries to comply with conditionality (Schimmelfennig / Sedelmeier 2004).

report accused the Rwandan government of supporting armed groups operating in the Eastern Democratic Republic of the Congo. Consequently European donors, among them the United Kingdom, Germany, the Netherlands and the European Commission suspended or delayed parts or full tranches of their budget support. Instead of coordinating these responses, however, they made their choices on an individual basis, in some cases without directly informing the Rwandan government. Decisions to reinstall parts of budget support were not coordinated either. The United Kingdom, for instance, unblocked half of the funds in September 2012 after holding consultations with the Rwandan government, before freezing it again in November at the request of its parliament.⁵ Germany unfroze its budget aid to Rwanda in February 2013⁶, switching from general to sector budget support, again without coordinating this move with other European donors.

2.3 Hypotheses

So far, we have seen that the controversy around the provision of GBS has caused a great heterogeneity of budget support policies among European donors, which in turn has led to severe coordination and harmonisation problems on the ground. On the one hand, for those in favour of increasing the weight of GBS, the aid effectiveness framework of the Paris Agenda provided the normative ground. Moreover, for proponents of budget support, the instrument has been perceived as an opportunity to improve the harmonisation among bilateral European aid strategies. On the other hand, those with more sceptical attitudes towards the instrument perceived budget support as a risky undertaking, with high fiduciary risks and as potentially strengthening authoritarian and neopatrimonial structures. Moreover, the instrument provided little visibility for donors in the case of successful development trajectories but bore the risk that donors could be held accountable for any political fault of the budget support-receiving regime.

Against this background, we contend that these arguments and preferences in favour and against the use GBS were not equally “distributed” amongst European governments and did not affect those governments’ behaviour randomly. Instead, we hypothesise that the varying donor preferences regarding the use of GBS were caused by particular characteristics of the domestic context in European donor countries that systematically impacted on their budget support policy. In particular, we formulate three hypotheses:

- 1) The provision of budget support has been influenced by the ideological position of the donor government, with right-wing European governments disbursing less budget support.
- 2) The domestic economic context in donor countries has had an influence on budget support provision, with lower economic growth rates having a disproportional negative impact.

5 <http://www.publications.parliament.uk/pa/cm201213/cmselect/cmintdev/726/72605.htm>.

6 <http://www.newtimes.co.rw/news/index.php?a=63514&i=15258>.

- 3) The provision of budget support has been influenced by the structure of the existing aid system, with project-based aid bureaucracies tending to be more reluctant to use GBS.

Ad 1) Party politics: Why should leftist governments be more supportive of budget support than conservative governments? Our answer to this question is that the constituency of right-wing governments is disproportionately sensitive to the entailed risks attached to the use of budget support (GBS). This argument is sustained by research on public opinion of European citizens towards development aid. Not only are citizens with more rightist political orientations less likely to support development aid in general (Lumsdaine 1993, 144, 153; Knack / Paxton 2011), which might be the reason why more conservative or right-wing governments are sometimes found to be more opposed to giving foreign aid than governments with other ideologies (e.g. Tingley 2010). Conservative constituencies are also more sceptical about the waste of foreign aid due to corruption in developing countries (Bauhr / Charron / Nasiritousi 2013) and thus more concerned about fiduciary risks. European citizens with more right-wing political orientations are also more likely to support interventionist forms of democracy promotion (Faust / Garcia 2014) and to condition the provision of foreign aid to the existence of democracy and “good” governance (Bodenstein / Faust forthcoming).

Consequently, we expect more right-wing governments to be more likely to adopt aid policies that can demonstrate tangible results to their comparatively critical core constituencies. In addition, conservative governments also need to respond more strongly to concerns that aid does represent value for money and does not strengthen authoritarian or neopatrimonial structures in developing countries. Right-wing governments tend to be more supportive of aid interventions that allow them to make their contribution to economic and political modernisation in recipient countries measurable and visible to their home constituency. Moreover, this type of donor government tends to be more selective in allocating foreign aid, providing aid only to relatively well-governed countries or at least to be more likely to sanction visible corruption scandals and violations of democratic and human rights standards. These policy preferences regarding the delivery of foreign aid all do not match well with the intervention logic of budget support.

Moreover, right-wing governments generally have a preference for development models where the private sector is the driving force of economic modernisation (see Boix 1997; Bartolotti et al. 2004). Thus, the use of GBS, which centres on a strong role of the state in providing public goods in the social sector, seems to be much more compatible with ideological positions that are located on the left of the political spectrum. Finally, political parties on the (extreme) right in many European countries have stronger nationalist positions and are on average more sceptical regarding multilateral institutions (Addison / McGillivray / Odedokun 2004). Accordingly, they should be more reserved in supporting joint financing mechanisms such as GBS.

For these reasons, we expect right-wing donor governments to be more reluctant to use budget support, however this is not to say that the potential risks of budget support are of no concern to governments with other ideological positions. These factors are important for explaining why GBS has never become the dominant European aid instrument. Still, for the reasons mentioned above, we expect that the ideological composition of a donor government does have a marginal effect on its preference regarding the use of GBS.

Ad2) Economic context: Why should the economic context in a donor country have an impact on the use of GBS? For similar reasons as those mentioned above, we expect a positive relation between the overall macroeconomic context – measured by economic growth – and the use of budget support. Most importantly we hypothesise that deteriorating growth rates have a negative impact on the use of GBS. In times of economic hardship, donor governments are particularly incentivised to demonstrate that their foreign aid achieves tangible results (see e.g. Dang / Knack / Rogers 2009) and does not disappear into the pockets of corrupt elites or be used for sustaining repressive authoritarian regimes. For this purpose, again, traditional projects are better suited than GBS, as they are better suited to correspond to a donor's desire for visible aid delivery (see Martens 2005). In addition, providing budgetary aid to other countries in times of austerity and severe budget constraints at home is likely to face public scepticism and discontent. Accordingly, one would expect donor governments to become more risk averse in times of economic crisis and therefore more reluctant to spend GBS compared to other aid modalities.

Ad 3): Structure of the donor country's aid system: This provision of budget support breaks with the traditional way of delivering aid characterised by clearly identifiable, earmarked financial and technical projects. The delivery of foreign aid through GBS diminishes the manoeuvring space of implementing agencies by forcing them to harmonise their aid interventions among each other. An increase in budget support provision thus threatens bureaucratic structures which are heavily based on traditional project-based aid delivery (see e.g. Nuscheler 2008). Budget support also requires aid interventions to be aligned according to the developmental preferences and the administrative procedures of the recipient country and aims at strengthening a developing country's own institutions and administrative systems. GBS can therefore be perceived as a threat to the bureaucratic interests of aid agencies that rely on a business-model related to the provision of (small-scale) projects and the sending and employment of technical experts from donor countries.

Aid agencies in general have been found to adapt only slowly, with strong internal interests considered as obstacles to change (Easterly 2007). The management of budget support does require different core competencies from aid bureaucrats and thus a process of adaptation and change. While sector-specific technical expertise is still needed, the primordial expertise of aid managers for managing budget support consists in their ability to successfully participate in policy and political dialogues that attempt to build the economic and political macro-frameworks for successful and sustainable development. This changing role of a successful aid manager can easily provoke resistance from traditional experts working in the field of foreign aid.

On the one hand, probably every European donor administration will face at least some resistance and obstacles to change of this kind. On the other hand, the organisation of aid systems in European countries is heterogeneous regarding the existence of specialised aid agencies, their political influence, as well as their reliance on traditional modes of delivery. Accordingly, we expect European governments to provide less budget support if their institutional set-up for managing foreign aid is characterised by comparatively influential implementing aid agencies that rely on modes of delivery unfavourable to the intervention logic of GBS.

3 Empirical inquiry

3.1 Cross-country evidence from Europe

In a first step, we approached our hypotheses on the impact of domestic politics on the provision of budget support with econometric methods. For this purpose, we examined the impact of domestic factors in 15 European donor countries on the varying amounts of their budget support disbursements in the 2002–2012 period.⁷

Dependent variable: To obtain a normalised distribution, we used the annual amount of budget support disbursements transformed into logarithmic values as one dependent variable for the 2002–2012 period. For the same period, we also took the proportion of budget support disbursements against the total amount of country programmable aid as the dependent variables for our inquiry. This choice was justified for two reasons: Following our main argument, the coordination problems among European donor governments at least partly stem from their respective domestic political environment, independent of developments in recipient countries. This expectation is sustained by recipient country analysis, where individual donors, in the exact same country situation, differed regarding their budget support disbursements, the dependent variable for our inquiry.⁸

Independent variables: We build a parsimonious model for explaining the variance of budget support disbursements. This is due to the short time span under consideration, and the fact that many potential economic or political factors of influence have remained (almost) constant over time. Moreover, as we mostly include country fixed effects to control for omitted variable bias, the between-country-variance tends to be fully absorbed by the country dummies. Thus, we include only independent variables in our analysis that reveal major changes during the 2002–2012 period.

7 We obtained data on general budget support disbursements for the 2002–2012 period from 17 European donors from the Creditor Reporting System (CRS) of the OECD's Development Cooperation Directorate (DCD-DAC). From this sample we excluded Greece and Luxemburg because of the limited amount of observations (four and two respectively) for the period under consideration. Given that the DAC statistics regarding GBS disbursements do not differ between 0 disbursements and missing values, we coded observations as 0 if no GBS disbursements had been made before (overall 10 observations). In other cases of missing values we obtained data through simple interpolation (5 observations). Thus we obtained a balanced panel with 165 observations. As a robustness check, we also performed the regressions without these 15 observations, the results showing no major differences to those reported in the subsequent table. Moreover, as DAC data only clearly differentiate between sector budget support and general budget support since 2010, we were not able to use this differentiation for our econometric analysis.

8 Some authors favour data on aid commitments over the use of aid disbursements because commitment data are better available for longer time periods and might better reflect the actual preferences of a donor government. However, for our relatively short time period, there is only a slight difference in the availability of commitment and disbursement data. More importantly, however, we would argue that disbursement data are better suited to analysing the particular instrument of budget support. In contrast to project aid, budget support gives donor governments a much higher degree of flexibility for augmenting or reducing their disbursement so that changes in budget support disbursements are likely to reflect the immediate consequences of a changing domestic context in the donor country. Still, in the Appendix we also provide the results from regression analysis using data on budget support commitments. As is show, the results are highly similar to those of Table 1.

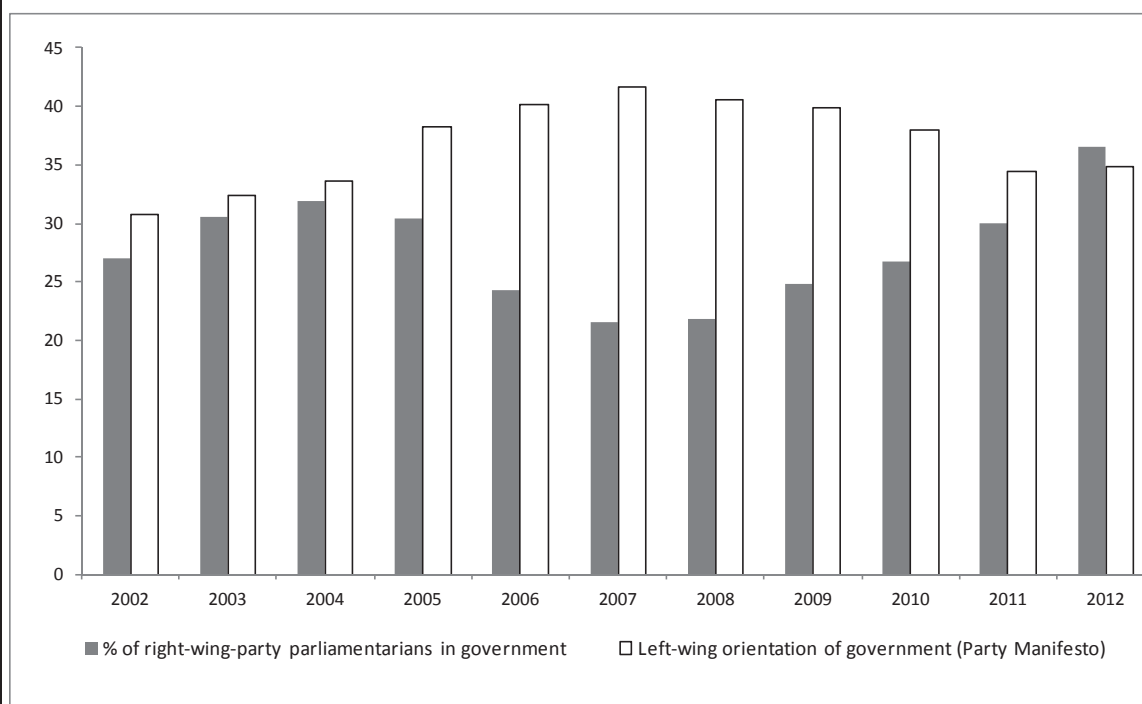
Most importantly, we examine the impact of the ideological composition of European governments with two different variables. As explained, we expect right-wing governments to be more reluctant to provide GBS. Accordingly, we include a variable that measures the number of parliamentarians who belong to a right-wing *government* party as a percentage of the overall number of parliamentarians (*RightWingGovParl*). Given the huge amount of coalition governments in Europe and the fact that all European governments are based on parliamentary or semi-parliamentary systems, this variable is more adequate to capture the ideological position of a government than by simply taking the party affiliation of the head of government into account. We obtained the necessary data to construct this variable from the World Bank data set on political institutions (Beck et al. 2001). Moreover, we built a more nuanced variable of a government's ideological position by using data from the Party Manifesto project (Volkens et al. 2012; Budge 2000). From these data, we construct a variable, where higher values indicate a more leftist position of government and then take the logarithm of the variable (*Government-Left*) in order to normalise its distribution.⁹ As can be observed in Figure 2, the average values of both variables depict a similar trend, particularly regarding the trend towards more conservative governments since 2007.¹⁰

In addition, we also include a variable for the intensity of a political system's "checks and balances" approximated by the number of veto-players (Tsebelis 2002), which is measured by the variable "Checks" from the World Bank Data Set on Political Institutions (Beck et al. 2001).

To measure the impact of donor countries' economic performance, we include (the natural logarithm of) *GDP per capita* to examine whether changes in *per capita* income have had an effect on the provision of GBS. Here, our expectation is that, particularly against the background of the European economic crisis, governments could easily be tempted to disproportionately cut GBS because this form of foreign aid is easier to suspend than project aid.

9 The Party Manifesto project codes party manifestos for every political party in a given country on several policy dimensions and positions political parties on a left-right scale, ranging from -100 (extreme left) to 100 (extreme right). We weight the importance of a government party by taking into account its position on the left-right scale and the percentage of its parliamentarians against the overall number of parliamentarians. Hereafter, we transform the variable into positive values so that greater values indicate a more leftist position.

10 Note that numbers in Figure 2 depict the average ideology of governments in our European sample in a given year and therefore show only gradual variation. In contrast, this variation at individual country level has often been much stronger when there have been changes in the composition of governments.

Figure 2: Average ideological composition across 15 European donor governments, 2002–2012

Source: Own compilation based on data from Party Manifesto

In order to investigate the extent to which a donor country's aid system might have influenced its provision of budget support, we build a time-invariant variable from a 2009 OECD report that describes the basic organisational characteristic of European foreign aid providers (OECD 2008). Remember that we expect donor countries with a project-focused set-up to be more resistant to providing higher levels of budget support because of vested bureaucratic interests and resistance. Likewise, donor countries without such a structural feature are likely to have found it appealing to disburse large sums of foreign aid via budget support. The OECD report's information enabled us to identify to which extent the aid systems of our sample countries were characterised by state-owned implementing aid agencies. Similar to previous studies (Fuchs / Dreher / Nunnenkamp 2014), we therefore constructed a dummy variable that took the value of 1 if there was a state-owned implementing agency outside the ministry responsible for development cooperation. Seven countries of our sample had such an agency: Austria, Belgium, France, Germany, Norway, Spain and Sweden. We also built a more nuanced variable on a 1-4 scale: 4 being a country with more than one implementing agency outside the ministry responsible for development cooperation (e.g. Germany, Norway); 3 being a country with one implementing agency outside the respective ministry (e.g. Austria, Belgium); 2 being a country with an implementing agency incorporated into the ministry; and 1 having no implementing agency during our period of investigation (e.g. Finland, the United Kingdom).¹¹

11 As information from other studies (Fuchs / Dreher / Nunnenkamp 2014) as well as from a 1998 OECD report reveals, these variables did not change over our period of investigation. Thus we are confident

As one can expect that donor countries that spend more on foreign aid will also provide higher sums of budget support, we controlled for the effect of the overall amount of *country programmable aid* (ln): In contrast to overall aid flows, country programmable aid captures the flows of aid that go to the partner countries and over which recipient countries have a significant say. Overall aid flows include debt relief, humanitarian aid, and in-donor-country-costs such as administrative costs and resources spent on refugees and students from developing countries and inflate aid that is available in developing countries. Including this variable is important because it identifies the effect of changing overall aid to developing countries on the use of budget support.

Estimation technique: To identify the effect of the independent variables on budget support disbursements in our balanced panel with 165 observations, (T=11, N=15), we use the standard OLS (ordinary least squares) procedure with panel corrected standard errors (Beck / Katz 1995; 1996). We prefer the Prais Winsten Transformation over the use of the lagged dependent variable. The reason for this choice is that “the inclusion of a lagged dependent variable and/or period dummies tends not only to absorb large parts of the trend in the dependent variable, but likely biases estimates” if there are reasons to believe that the explanatory variables can explain a major part of the existing trend of the dependent variable (Plümper / Tröger / Manow 2005, 349). Still, we include a dummy variable for the 2007-2012 period in order to control for a potential trend effect due to the European economic crisis or a trend towards more conservative governments. Finally, we include country dummies in order to avoid omitted variable bias and to identify the importance of contextual, time invariant country factors.¹²

As Table 1 reveals, Models 1 and 2 provide substantial support for our hypotheses. Firstly, a change towards a more conservative government composition has had a negative and exponential impact on the total amount of budget support disbursements. According to the results of Model 1, a one-unit increase of the variable leads on average to a 0.9 % decrease in budget support disbursement; an increase by 50 units has on average provoked a 56% decrease in budget support disbursements. In other words, a change in government from a situation with no right wing parliamentarians in government to a situation where right wing parliamentarians in government represent 50% of overall parliamentarians has been associated with a reduction of budget support disbursement by 56%.¹³ Moreover, Model 1

that using these variables captures an important part of the structural differences of the donors' aid systems and that our analysis is not confronted with a reverse causality problem.

- 12 Against our theoretical background, including country dummies is sufficient to deal with potential problems of endogeneity. We find no plausible reasons for a reverse causality problem as neither a government's ideology nor its economic domestic context should be influenced by the amount of budget support disbursements.
- 13 We find a smaller, albeit still substantial, effect when using our alternative variable for government ideology with data from the Party Manifesto project. As both the dependent and the independent variable have been log transformed, the effect should be interpreted as an elasticity. Remember that our ideology scale has ranged from 0 to 70, higher values meaning more left-wing orientation of government. Accordingly, a 10% change in our transformed Party Manifesto indicator towards the political left increases the budget support provision by approximately 3% ($1.10^{.33}=1.03$). A 100% increase, for instance moving from a value of 30 to a value of 60 on our scale, increases the amount of

depicts that there has been a statistically significant influence of a government's ideological position; the veto-player variable has had no such impact.

Secondly, the macroeconomic context has also had a significant impact on the provision of budget support. These findings show that many European governments have reduced budget support disbursements in times of economic crisis. While overall aid goes down as well, budget support decreases disproportionately. Against the fact that GDP *per capita* growth rates have roughly ranged between -8 and 3% in the period under observation, the effect of the variable again seems plausible: a one percentage decline of GDP *per capita* provoked a decline of GBS disbursements by approximately 5%. Not very surprisingly, the CPA variable has a positive sign and is also statistically significant, meaning that an increase in country programmable aid has been associated with an increase in budget support disbursements.

In Model 2, the dependent variable is the percentage of budget support disbursements against overall CPA. As Model 2 shows, both variables measuring the ideological position of the government are again highly significant and have the expected sign. The same holds for the domestic economic context as proxied by GDP *per capita*. The size of the coefficients also points to a substantial effect of government ideology and the domestic economic context when the relative weight of budget support is concerned. For instance, an increase in one unit of the government composition towards the right has led to an average decrease of approximately 0.025 of the share of budget support disbursements. An increase by 50 units – (here 50%) – would have meant a decrease by 1.25%, which is still substantial considering that the average share of budget support was only about 5.5%. In contrast to Model 1, the variable measuring the overall amount of CPA lost its significance. Accordingly, whether a country gives more or less foreign aid has had no statistically significant impact on the percentage of budget support it provided.

Hereafter, we tested whether our identified effects were truly specific to the provision of budget support and not to the overall provision of foreign aid. We used the amount of CPA disbursements (in logarithmic values) as the dependent variable. As Model 3 depicts, the overall amount of country programmable aid has not been affected in a similar way by the independent variables as budget support disbursements have. First, the impact of the ideological variables was no longer robust. The percentage of right-wing parliamentarians in government was still slightly significant but the size of the coefficient had decreased substantially. Yet, the Party Manifesto-related variable was far from being statistically significant and had even changed its sign. Regarding the economic context, the GDP *per capita* change within in a country – while being statistically significant – had a smaller effect on overall CPA than on the disbursement of budget support. Overall, the comparison of Models 2 and 3 therefore show that partisan politics and the economic context had a stronger impact on the contested aid instrument of budget support than on the overall disbursements of foreign aid.

budget support by 27%, while a 600% increase, such as a move from 10 to 60, would have implied an increase of budget support disbursements by 84%.

The significance of many of the unit fixed effects in Models 1–3 reveals the existence of contextual factors at the country level affecting budget support disbursement. For instance, the two non-EU donors, Norway and Switzerland, reveal disproportionally low budget support disbursements. Moreover, the country coefficients of Germany and the United Kingdom suggest that the two major European bilateral donors differed substantially in their country context.

We then turn to the question of whether the contextual factors are related to our third hypothesis about the negative impact of implementing agencies on budget support provision. To answer this question, Models 4 and 5 again use the proportion of budget support disbursements as a percentage of overall CPA but abstain from using country dummies. Instead, the latter are replaced with two time-invariant variables. Most importantly, we introduce the variable(s) measuring the existence of implementing agencies. As further controls, we use the number of former colonies of donor countries (in logarithmic terms) and differentiate between the two non-EU member countries and the rest of the sample. While we recognise that leaving out unit-fixed effects and substituting them for a selected number of time-invariant variables can potentially cause an omitted variable bias problem, the result still provides substantial support to our hypothesis. As Models 4 and 5 show, both proxy variables for differentiating between the relevance of implementing agencies across European donors have a negative sign and are highly significant. Accordingly, aid systems characterised by implementing agencies tended to provide less budget support. Moreover, European donors with more former colonies have tended to provide more budget support, while the two non-EU members seemed to provide disproportionally less than EU member states.

Table 1: Domestic drivers of budget support disbursements

	Model 1 BS (absolute)	Model 2 BS (% CPA)	Model 3 CPA (absolute)	Model 4 BS (% CPA)	Model 5 BS (% CPA)
	FE	FE	FE	Agency 1/4	Agency 0/1
<i>RightWingGovParl</i>	-.0092*** (.003)	-.025** (.01)	-.02 (.14)	-0.03** (0.01)	-0.03** (0.01)
<i>GDP per capita (ln)</i>	4.95** (2.56)	15.55** (6.27)	1.20** (.59)	17.48*** (4.29)	18.77*** (4.39)
<i>CPA (ln)</i>	.57** (.27)	-.35 (.49)		.74* (.42)	.47 (.38)
<i>Checks</i>	.17 (.14)	-.18 (.36)	.02 (.03)	-.004 (.354)	-.077 (.35)
<i>2007–2012</i>	.10 (.24)	.05 (.54)	.00 (.06)	-.138 (.538)	.17 (.55)
Agency 1/4				1.46*** (.45)	
Agency 0/1					-3.13*** (1.01)
Non EU Country				-2.94** (1.37)	-3.50*** (1.27)
Number of colonies (ln)				.911* (.48)	1.27*** (.50)

Continued table 1: Domestic drivers of budget support disbursements					
Austria	-2.61*** (.70)	-7.7*** (1.5)	-2.29*** (.22)		
Belgium	-1.97*** (.62)	-6.41** (1.29)	-1.01*** (.09)		
Denmark	-1.11* (.57)	-3.60*** (.84)	-.07 (.07)		
Finland	-.60 (.48)	-1.52 (1.14)	-1.41*** (.08)		
France	1.20** (.53)	2.32 (2.22)	1.26*** (.13)		
Germany	-1.27** (.62)	-5.27*** (1.04)	1.13*** (.09)		
Ireland	-1.43** (.55)	-2.29 (1.51)	-1.73*** (.14)		
Italy	-.49 (.75)	-2.58 (2.03)	-.71*** (.17)		
Netherlands	-.35 (.30)	.58 (1.74)	.12 (.14)		
Norway	-1.88** (.91)	-5.85** (2.39)	-.35 (.23)		
Portugal	-.04 (1.21)	-1.03 (3.06)	-1.14*** (.31)		
Spain	-1.48** (.63)	-4.28*** (1.38)	.14 (.28)		
Switzerland	-1.30** (.54)	-6.38*** (1.68)	-.69*** (.14)		
United Kingdom	1.17*** (.37)	6.45*** (1.73)	.88*** (.11)		
Constant	-51.53* (26.55)	-149.73* (64.90)	-4.4 (6.12)		
Observations	165	165	165	165	165
R2	.65***	.56***	.95***	.27***	.32***
Wald Chi2	2194***	423***	37149***	47.62***	53.7***
Government Left	.34** (.15)	.67*** (.23)	-.005 (.016)	.63** (.27)	.71*** (.25)
OLS with panel corrected standard errors and Prais Winsten Transformation Standard errors in parentheses, * p < 0.10, ** p < 0.05, *** p < 0.01 Source: Authors					

3.2 Comparing Germany and the United Kingdom

3.2.1 Case selection

To trace the impact of partisan politics on the provision of GBS, and to better understand the impact of the institutional set-up of a donor country's foreign aid system on its preferences for budget support, we provide qualitative evidence examining the cases of Germany and the United Kingdom – Europe's largest bilateral donors. Choosing these two countries seems to be appropriate for a *between-country-comparison* as well as for a *within-country-comparison*: both can be closely related to our statistical analysis, where we revealed significant within-country-effects of variables such as government ideology and GDP *per capita* but also important between-country-effects through the inclusion of unit fixed effects.

Regarding the between-country analysis, there is a huge difference in the *amount of budget support disbursements* between the two countries over the entire period of investigation. While the UK evolved as Europe's most important bilateral provider of budget support, Germany remained much more reluctant in channelling its aid resources via the instrument. As can be seen from Table 1, the average percentage of UK budget support was around 15% and peaked at a maximum of 20%, while in the case of Germany, budget disbursements were far below and never exceeded 5% of total CPA. Our regression analysis sustains this difference. As is depicted in Table 1, Models 1 and 2 show highly significant and positive coefficients for the UK country dummy variable, while the coefficients for Germany are highly significant and have a negative sign. This suggests that time invariant factors such as structural differences in their aid system might have influenced the budget support policies of these countries. A comparison of both countries' policy structures in development cooperation is thus likely to reveal different incentive schemes that have impacted on their governments' choices causing them to use the instrument to such different degrees.

Besides these "time invariant" differences between the two countries, there is also within-country variance regarding budget support disbursements in both countries. Within both countries, we can observe changes during the investigation period regarding the use of budget support. Given that there were changes in the government composition and the domestic economic context, this within-country variance of budget support disbursements allows the impact of partisan politics and the economic context *within* each country to be traced.

3.2.2 Between-country comparison: The aid system in Germany and the United Kingdom

While Germany and the UK are Europe's largest bilateral donor countries, each having an independent Ministry of Development Cooperation, the aid systems in both countries nevertheless show some significant differences that have hindered or promoted the provision of budget support.

In the *United Kingdom*, the institutional set-up has changed back and forth over the last decades with the Department for International Development (DFID) and its predecessors

either being independent departments or part of the foreign office.¹⁴ Re-established as an independent department for development in 1997, DFID issued two influential White Papers in 1997 and 2000, making poverty reduction the overriding aim of the UK's international development policy. In 2002, the International Development Act was passed, enshrining the reduction of poverty as the single purpose of development aid in British law (Solesbury 2003; Barder 2005). In addition, the amount of ODA spent by the British government increased rapidly since the late 1990s. While the percentage of British ODA to GDP was below 2.5% before 2000, it increased to almost 0.7% in 2013. In absolute terms, bilateral ODA increased from USD 2.8 to 8.7 billion (constant 2012 prices) during the 1998-2012 period, while overall British aid increased from 5 to 14 billion in the same period. Moreover, DFID established itself as a global leader on development issues, and was at the forefront of promoting aid effectiveness principles. In this context, DFID was among the most progressive European 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).

In line with the increase of DFID's increasing political and financial weight, the organisation drafted a very progressive budget support policy in 2004, stating that budget support would become the department's preferred aid modality. In doing so, DFID faced comparably little resistance from interest groups within the UK or other departments. One reason for this development was the relative autonomy of DFID over its policies and budget and little resistance against this policy shift. As the British aid system does not have public implementing agencies, the lobby for project-driven aid delivery was comparatively weak, even more so since the 2002 International Development Act reduced the role of the private sector and formally abolished tied aid (Barder 2005).

The structure and approach of the UK's NGOs are also heavily influenced by DFID, which changed its funding structure for NGOs in the early 2000s. In the following, new funding criteria required a stronger focus on advocacy and rights-based approaches, away from the traditional service-delivery role of NGOs. These funding criteria are in line with DFID's change under Labour from using NGOs as an implementer of development aid to a stronger focus on government-to-government aid, such as budget support (Wallace 2003). Moreover, there are many large advocacy and campaign-oriented international NGOs based in the UK which subscribed to the aid effectiveness agenda and supported the idea of programme-based approaches and budget support, also because this did not undermine their own business model. DFID thus faced comparably little domestic resistance when implementing its budget support policy in 2004. In combination, the absence of implementing aid agencies and the sharp increase in bilateral ODA also increased the disbursement pressure within DFID, making budget support a highly attractive aid instrument for disbursing large amounts of aid.

14 From 1979 until 1997, the UK was governed by a conservative government, with the then Overseas Development Administration being part of the Foreign Office. In 1997, the Labour Party re-established DFID as an independent department, following a party report, which recommended not only the creation of a separate government department but also less emphasis on commercial and strategic motivations in providing foreign aid and a stronger focus on poverty reduction (Barder 2005).

The *German* aid system strongly differed from the situation in the UK. Germany has had an independent development ministry since the foundation of the Federal Ministry for Economic Cooperation and Development (BMZ) in 1961. Despite this longer history of an independent ministry, interest groups within the aid system have played a much stronger role in shaping German development policy. Most importantly, Germany has very strong public implementing agencies, both for technical and financial development assistance. In our period of investigation, Germany had three different organisations for technical cooperation, among them the world's largest bilateral provider of technical assistance, the Gesellschaft für technische Zusammenarbeit (GTZ).¹⁵ Beyond, Germany's aid system is also characterised by a neo-corporatist system of project implementing NGOs, including the influential political foundations, NGOs linked to the churches, as well as many private NGOs organised under the umbrella association of VENRO. The German aid system has been repeatedly criticised by OECD/ DAC Peer Reviews for its fragmented implementation structure, its tendency towards project proliferation and for imposing a high amount of transaction costs on developing countries (OECD / DAC 2005; 2010).

Among Germany's state owned implementing agencies, only the financial cooperation agency KfW Development Bank became more supportive to budget support, not least because its provision – technically channelled through the KfW – strengthened the organisation's profile *vis-à-vis* partner country governments and technical cooperation. The opposite was true for the GTZ, which saw its interests and profile threatened by potentially increasing amounts of budget support and strongly lobbied against this aid instrument from the beginning (Nuscheler 2008). Budget support also ran counter to the interests of most German NGOs, which also relied on a small project-based aid delivery model and were often heavily subsidised by official ODA funds (Dreher et al. 2012). Overall, BMZ was confronted with a rather strong opposition against a substantial increase in budget support by most state-owned implementing agencies and by NGOs embedded in a neo-corporatist structure. At the same time, the German ministry did not face similar disbursement pressure as in the case of the UK because it was not confronted by a similar rise in ODA. In addition, Germany's implementing agencies employ a substantial number of aid workers, creating incentives to continue channelling ODA through projects.¹⁶

Overall, the between-country comparison of Germany and the UK thus reveals the impact of the different institutional set-ups and the interests of particular actors in the aid system that have led to a more or less favourable environment for the provision of budget support.

15 In 2011, the three technical assistance organisations GTZ, DED (Deutscher Entwicklungsdienst) and InWEnt (Internationale Weiterbildung und Entwicklung) were merged to one single aid agency – the Gesellschaft für Internationale Zusammenarbeit (GIZ).

16 Absolute German ODA increased from USD 7.3 to 12.9 billion (in 2012 constant prices), while bilateral German ODA increased from 4.6 to 8.6 in the 1998–2012 period. Moreover an OECD report from 2008 reveals that Germany employed more than twice as many aid workers in its public aid system than the UK (4479 vs. 1828), even if excluding the huge amount of local staff members in technical cooperation projects.

3.2.3 Within-country comparison: party politics and the economic context

Despite these time invariant differences between the two countries, the variables of our statistical analysis have an impact on both countries, meaning that we should be able to trace the same political dynamics with regards to GBS policy. This is especially true with regard to party politics, where a change in government had an impact on the budget support policy in both country cases. In both, Germany and the UK, a conservative government or conservative-dominated coalition was more sceptical and reluctant to provide budget support than left-wing governments or coalitions.

In the UK, the former labour government was in power when budget support started to emerge at the end of the 1990s. When DFID drafted its first budget support policy in 2004, which stated that GBS would become the department's preferred aid modality, the policy faced little party-political resistance. Budget support was also in line with Labour's new direction for development policy, which supported a stronger focus on poverty reduction, institution-building and programme-based approaches. The Parliament, as in other European countries, remained sceptical and requested reassurance from DFID that budget support would not be misused for unintended purposes such as military spending and defence. DFID, however, remained firm and put a lot of effort into convincing MPs that the benefits of GBS outweigh potential risks (Warrener 2004).

The major turn in DFID's budget support policy took place under the Tory (centre-right) government, which came to power in 2010. Already in its Green Paper "One World Conservatism", published ahead of the elections, the Tories distanced themselves from the Labour Party's approach to budget support by stating that *"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 Tory government announced that it would halve budget support operations by 2015 and that, in the future, sector budget support would be preferred over GBS. Sector budget support seems to be more in line with the government's focus on results in social sectors and value for money, whereas the previous government strongly focused on macro-political reforms and institution-building.

In Germany, a left (social democrat-green government) was in place between 2002 and 2005. This left-wing coalition was generally in favour of budget support and started to promote the instrument at the beginning of the 2000s. The domestic interest conflicts outlined above, however, led to a rather moderate use of the instrument despite a government coalition that was generally supportive of budget support. Hereafter, from 2005 to 2009, Germany was governed by a coalition of social democrats (SPD) and conservative (CDU/CSU) parties. Even though the Development Ministry remained in the hands of the SPD, the CDU had won a larger share of the votes and thus the right to the Chancellor's position. In the following months, the overall budget support policy changed gradually. The Coalition Treaty provided for the use of budget support in well-governed developing countries and the Development Minister, Ms Wieczorek-Zeul, also planned to increase its use. There was, however, strong scepticism in both the Finance Ministry and the Budget Committee, where representatives of the right-wing coalition parties had a majority. In 2007, the Budget Committee commissioned a report to the Auditor General. The report did not question the instrument as such but highlighted the high fiduciary risks and recommended a strict and careful use along with a case-by-case assessment of every

budget support provision by the Budget Committee. Since 2008, every budget support operation has thus been subjected to the approval of the Budget Committee, which used its veto power for instance in 2009, when the ministry proposed budget support to Benin (Hermle / Hauschild 2012). Debates in the German Parliament also revealed that the Liberals (FDP) were lobbying heavily against budget support, whereas the conservative CDU confirmed that they were critical but not fully reluctant towards budget support, provided that it was granted to only a few selected good performers.¹⁷

In 2010, a new, right-wing coalition came to power (CDU/CSU/ FDP) and changed the existing approach to budget support radically (Hermle / Hauschild 2012). The now FDP-led Development Ministry announced that no new budget support operation would be established in that legislative period and some of the former recipients saw a reallocation from budget support to other aid modalities. The FDP Development Minister publicly declared that his party considered the very idea of budget support as flawed and the wrong approach in development policy.¹⁸ In sum, party and ideological composition of the German government had a strong impact the country's budget support policy throughout the three legislative periods under scrutiny. Even though Germany was from the beginning a rather moderate provider, average disbursements decreased significantly under the right-wing coalition. In both cases, the UK and Germany, party politics and the ideological composition of the government had a strong influence on budget support provision.

Figure 3: Overview within case comparison

Germany:

2002–2005

centre-left government

Increasing support for BS

2006–2009:

great coalition

Constraints for use of BS

2010–2013:

centre-right government

Gradual exit-strategy regarding BS

United Kingdom:

2002–2009

Left/Labour

Strong support for BS

2010–2013

Conservative /Tories & Liberals (2010–13)

More reluctant towards BS

Source: Authors

4 Conclusions

This paper has aimed at analysing the domestic politics behind the heterogeneity of budget support provision in European countries. From an aid effectiveness perspective, budget support provided a number of in-built characteristics to implement the aid effectiveness principles of the Paris Declaration and the Accra Agenda for Action. Moreover, the intervention logic of budget support is conducive to increasing the coordination among European donors and also provides a framework for including the normative aspirations of

¹⁷ dipbt.bundestag.de/dip21/btd/16/125/1612512.pdf.

¹⁸ <http://www.fr-online.de/aegypten-syrien-revolution/dirk-niebel--wir-halten-allgemeine-budgethilfe-fuer-falsch-,7151782,7177718.html>.

European donors to strengthen transparent and accountable state structures. In principle, budget support could therefore have contributed to a more coherent and harmonised European development policy.

On the other hand, these expected benefits of budget support never fully materialised, at least partly because donors only reluctantly engaged in its provision. Despite being suited to make aid more effective, budget support bears high political risks for donor governments, and has, from the beginning, been a highly contested aid modality. The political risks associated with the use of budget support have been handled differently by European donor countries, which has led to a large variety in budget support policies causing harmonisation problems on the ground despite the original purpose of using budget support as a driver of improved donor harmonisation. We placed our analysis in the context of the sluggish implementation of the Paris Agenda (see Wood et al. 2011) and expected the reasons for the rather moderate use of budget support to be found in the domestic political context of donor countries.

As we have demonstrated in our quantitative and qualitative analysis, the different preferences for the use of budget support were not randomly distributed among European donor governments but were heavily influenced by their political economy. The political economy factors relate to the differences in the ideological composition of governments, varying domestic economic contexts, and the structure of the existing aid system. As those features vary strongly within and between European donor countries, they present serious barriers to implementing the aid effectiveness principles and to harmonising aid practices in a decentralised way. Against the evidence presented in our paper, it seems highly questionable whether progress regarding the implementation of the aid effectiveness principles can be made without acknowledging the domestic political context and interests in donor countries. It also seems highly questionable whether Europeans will be able to harmonise their development policies in a decentralised manner. In order to increase Europe's collective action capacity towards the developing world, serious progress towards more binding coordination mechanisms is essential. In the case of budget support, or what remains of it, delegating more policy and coordination competences to the European Commission to manage a truly European approach to the instrument needs to be the way forward.

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Annex

Table A1: Variable definitions and descriptive statistics						
Variable name	Variable definition	n	Mean	Standard deviation	Min.	Max.
<i>Budget support disbursement (ln)</i>	Amount of Budget Support (ln) disbursed by a single donor in the given year according to data from the Creditor Reporting System of the OECD /DAC	165	3.52	1.75	0	6.50
<i>RightWingGovParl</i>	Amount of government parliamentarians that belong to a right-wing political party according to the data from the Database of Political Institutions	165	.27	.22	0	.67
<i>Government-Left (ln)</i>	Ideological position of a government on a left-right scale according to data from the Party Manifesto project	165	3.44	.77	-.123	4.27
<i>GDP per capita (ln)</i>	Gross domestic product <i>per capita</i> in purchasing power parity (ln). Data obtained from the World Development Indicators	165	10.34	.174	9.95	10.85
<i>Country programmable aid (CPA) (ln)</i>	Country programmable aid (ln) disbursed by a single donor in the given year according to data from the Creditor Reporting System of the OECD /DAC	165	6.83	1.04	4.43	8.59
<i>Checks</i>	Number of veto-players in a political system according to the data from the Database of Political Institutions	165	4.20	1.07	2	7
<i>Agency</i>	Existence of a state-owned implementing agency outside the ministry responsible for foreign aid	165	.53	.5	01	1
<i>Agency 4/1</i>	Ranking of state-owned implementing agencies, differentiating between agencies within and outside the ministry responsible for foreign aid	165	2.47	1.03	1	4
<i>Agency 0/1</i>	Existence of a state-owned implementing agency	165	.47	.50	0	1
<i>Number of colonies</i>	Number of colonies a donor country had in the past	165	.76	11.80	39	0

Table A2: Agency variables and number of staff working at headquarters and as expatriates in developing countries (2007)		
	Agency 4to1	Agency 0 / 1
Austria	3	1
Belgium	3	1
Denmark	2	0
Finland	1	0
France	3	1
Germany	4	1
Ireland	2	0
Italy	1	0
Netherlands	2	0
Norway	4	1
Portugal	2	0
Spain	3	1
Sweden	4	1
Switzerland	2	0
United Kingdom	1	0

Table A3: Robustness check: domestic factors and GBS commitments				
	Model 6 BS (absolute ln)	Model 7 BS (% CPA)	Model 8 BS (% CPA)	Model 9 BS (% CPA)
	FE Model	FE Model	Agency 1/0	Agency 1/4
<i>RightWingGovParl</i>	-.015*** .006	-.06** 0.03	-.064** 0.025	-.065** 0.026
<i>GDP per capita (ln)</i>	-1.39 4.15	-.08 21.89	20.07*** 6.06	19.11*** 6.27
<i>Country programmable aid (CPA) (ln)</i>	1.44*** .38	1.89 1.52	1.35 1.14	1.62** 1.23
<i>Checks</i>	-.20 .22	-1.49 1.08	-1.30 .71*	-1.25 .73
<i>2007–2012 period</i>	-.23 .24	-1.62 1.23	-2.57* 1.35	-2.35* 1.25
<i>Agency 1/4</i>				-1.81** .09
<i>Agency 0/1</i>			-4.14*** 1.62	
Non EU Country			-4.80** 2.39	-4.00* 2.35
Number of colonies (ln)			.12 .09	.09 .08

Continued table A3: Robustness check: domestic factors and GBS commitments				
Austria	1.50 1.49	-1.09 6.09		
Belgium	-.03 .91	-5.86 4.39		
Denmark	.60 1.05	-1.87 5.08		
Finland	1.05 1.04	1.79 5.45		
France	.70 1.13	-1.34 6.22		
Germany	-.91 1.01	-7.85* 4.74		
Ireland	1.65 1.33	1.31 6.00		
Italy	-.30 1.27	-5.76 5.73		
Netherlands	1.25 .90	6.34 5.02		
Norway	1.49 1.71	-.54 9.13		
Portugal	-.57 2.01	-7.10 10.94		
Spain	-2.01 1.26	-10.03* 6.07		
Switzerland	1.01 .96	-3.76 5.27		
United Kingdom	.69 .81	4.47 4.28		
Constant	8.94 42.77	5.79 27.77		
Observations	184	184	184	184
R2	.52	.33	.19	.17
Government Left	.31** .13	.92* .59	1.25* .69	1.15* .63
OLS with panel corrected standard errors and Prais Winsten Transformation Standard errors in parentheses, * p < 0.10, ** p < 0.05, *** p < 0.01 Source: Authors				

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