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HARMONISATION AND ALIGNMENT:
THE DOUBLE-EDGED SWORDS OF BUDGET SUPPORT
AND DECENTRALISED AID ADMINISTRATION

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Abstract

The Paris declaration of 2005 on aid effectiveness is now part of the international consensus. It holds that increased use of budget support combined with decentralised aid administration will lead to transaction costs reductions (through better donor harmonisation of aid) and to enhanced local ownership (through better alignment of donor policies and practices with those of recipients). Both improvements are assumed to enhance aid effectiveness.

This article argues that the “partnership” perspective, which underpins much of the official thinking about harmonisation and alignment, is not able to capture the divergent interests and strategies of the multitude of donors and recipients. A more realistic “political economy” perspective on the harmonisation and alignment agenda is therefore proposed. It assumes that: different actors do not have the same interests; staff incentives to work to improve harmonisation and alignment are often weak among both donor and recipient stakeholders; and information about stakeholder strategies, interests, budgets etc. is incomplete. It is demonstrated that analyses based on this alternative perspective could lead to markedly different conclusions from those contained in the generally accepted consensus. There is a strong need for further analyses to guide future policy decisions in this field using the political economy perspective.

1. Introduction

“After reading the literature one can hardly say ‘aid’ without adding ‘coordination’ “ (Easterly 2002, p. 14), Yet, aid coordination has been on the agenda for decades without much progress, and some regard the lack of coordination as one of aid’s “seven deadly sins” (Birdsall 2005). This concern with harmonisation of donor support shows no sign of abating. Nor does the more recent concern with alignment of the support with recipient priorities and institutions. On the contrary, there is a growing international consensus about the need for better donor harmonisation and alignment, and about the benefits that this will bring in terms of decreased transaction costs and increased local ownership and hence improved quality of aid. Joint declarations on donor harmonisation and alignment have therefore been made at several recent international meetings and conferences in Rome (February 2003), Marrakech (February 2004) and Paris (March-April 2005). Attempts to translate these declarations into specific actions and activities are also numerous.

The documents for the Paris meeting in 2005¹ emphasise a “partnership” perspective on development assistance: “development programmes often take place in the context of a partnership between partner countries and donors... partners and donors have common development objectives” (OECD-DAC 2005a, p. 9). Moreover, donors should “harmonise their activities” and partner countries should enter into “partnership commitments...developed in a spirit of mutual accountability” (OECD-DAC 2005c, p. 3 and 7).

Two key instruments to achieve this are increased budget support and decentralised aid administration. Budget support - in contrast to the previous preference for project aid and aid channelled through project or programme management units - will help to reduce transaction costs, i.a. by reducing the number of individual projects and programmes. It will also increase local ownership. Decentralised aid administration – the transfer of tasks, decision authority and personnel from donor headquarters to embassies and representations in partner countries - is conducive for a more effective dialogue both among donors and among donors and recipients. This will therefore also contribute to lower transaction costs and to enhance local ownership.

¹ See in particular OECD-DAC (2005a), OECD-DAC (2005b) and OECD-DAC (2005c).

Progress on the actual implementation of the harmonisation and alignment agenda has, however, been mixed. In addition, experience shows that efforts to harmonise and align may not lead to the intended results.

This paper has three purposes. First, to outline a “political economy” framework to analyse harmonisation and alignment efforts. It builds on realistic assumptions about stakeholder preferences, incentives for cooperation, and incomplete information. Second, to disaggregate the concepts of transaction costs and local ownership – two main indicators of the harmonization and alignment agenda - so as to make them more operational. Third, to illustrate that budget support and decentralised aid management – two key policy instruments that are generally thought to further harmonisation and alignment – may, contrary to predictions based on the prevailing “partnership” perspective, lead to increased and unintended transaction costs and reduced local ownership under conditions which are common in many aid-dependent countries. In other words, these instruments can, depending on actual practices on the ground, be double-edged swords.

The article is organised in five sections. In section 2 the challenges of the international harmonisation and alignment are briefly discussed. Section 3 presents the analytical framework. Based on specific assumptions about preferences, incentives and information a “partnership” and a “political economy” analytical perspective are outlined, and it is argued that the latter is best able to capture the complex donor-recipient relationships. Section 4 contains a brief analysis of the implications of budget support and decentralised aid administration for transaction cost reductions and strengthened local ownership from a political economy perspective. Section 5 presents the main conclusions.

2. The challenges of harmonisation and alignment

Various instruments are used to improve donor harmonisation and to align donor support with recipient priorities, institutional arrangements and procedures. Budget support and decentralised aid management are considered as two key instruments. Other instruments include joint analytical, sector, review and evaluation work; joint capacity development and technical assistance; development policy and assistance strategy coordination; harmonisation of financial management and accountability procedures; coordination of financial and non-financial reporting requirements; joint procurement procedures, etc.

MIXED PROGRESS

Despite the increased use in recent years of the various instruments, the documents for the Paris meeting (and much academic research) conclude that the results of the harmonisation and alignment agenda are mixed. One indication is that: "... there is not enough evidence that harmonisation initiatives have helped curb transaction costs. Indeed, over the short term at least, they may have actually increased the costs" (OECD-DAC 2005a, p. 9).

Another indication is that few donor missions – less than 10 per cent in 2003 (OECD-DAC 2005a, p. 21) – are carried out jointly. This signifies that harmonisation has not gone that far. Moreover, the number of donor missions is still relatively high despite the increased local dialogue that the decentralisation of aid administration has facilitated (OECD-DAC 2005a, p. 22).

The limited implementation progress is often linked to technical factors like insufficient clarity in policy and investment priorities, absence of robust medium term expenditure frameworks that link country priorities to budget decisions, and insufficiently developed administrative systems in a number of areas (OECD-DAC 2005b, p. 9). This is also reflected in the Paris Declaration and in its selected progress indicators (OECD-DAC 2005c).

There are, however, additional explanations for the mixed progress. On the one hand, "[e]vidence from the field suggests that there is a considerable increase in common donor approaches in support of poverty-reduction strategies and the like, for example through budget and sector support..." On the other hand, "...the approach still involves almost every individual actor wishing to participate in every decision. As long as this continues, the transaction costs, at least to donors and very probably also to recipients, will remain high." (OECD-DAC 2005, p. 25) The simultaneous attempts to harmonise and align combined with efforts by individual donors to stay involved may simply "generate more 'noise', consuming more and more time" (OECD-DAC 2005b, p. 10). Consequently, "...donors and partners will have to make considerable more efforts to make a reality of the Rome Agenda" (OECD-DAC 2004, p. 1).

PROLIFERATION

The mixed progress on the harmonisation and alignment agenda should be seen in the context of a significant dispersion of aid over the last decades. The large number of non-coordinated donor projects and programmes has led to the flourishing of diverse donor procedures and practices. Some documentation for these trends can be found in the background material for the 2005 Paris meeting, but these trends are also documented by Knack and Rahman (2004); Birdsall (2005);

Acharya, Fuzzo de Lima and Moore (2006); and Roodman (2006)². Despite considerable conceptual and measurement problems in these analyses, some general conclusions can be drawn.

First, the number of individual donors providing development assistance has grown considerably, and globally the number of donors has increased faster than aid (Acharya, Fuzzo de Lima and Moore 2006, p. 1). This is a consequence of the emergence of new donor countries and, in particular, of the growth in NGOs.

Second, the number of commitments on development projects and programmes tripled between 1995 and 2003. This is a remarkable rise although it is partly due to improved reporting (Roodman 2006, p. 6-7).

Third, each individual donor provides assistance to many countries and sectors. Proliferation, measured as the tendency of donors to work in many countries and sectors in each country, has grown. Data for 1999-2001 show that on average each donor works in approximately 100 different countries, and that they spread their aid thinly on a number of different activities (Acharya, Fuzzo de Lima and Moore 2006, p. 2). In addition, a donor may fund up to 100 different projects in a specific country (Birdsall 2005, chart 4B).

Fourth, as a consequence of the above tendencies, each recipient country deals with a growing number of donors (Acharya, Fuzzo de Lima and Moore 2006; Knack and Rahman 2004, p. 18). In a typical aid dependent country there can be more than 20 active bilateral donors, 20 multilateral donors and several hundred NGOs. Some of the donors are, however, very small and only fund a minor share of the aid to a given country or sector. The fragmentation of aid seen from the recipient is thus high and probably not decreasing.

This development is often related to increasing aid levels. With the recent international commitments to scale up aid so as to reach the Millennium Development Goals in 2015, current problems of lack of harmonisation and alignment are obviously likely to intensify. This is especially the case for many African countries. They are already highly aid dependent and can expect rapidly increasing aid inflows in the coming years.

² Actually aid harmonisation and alignment has been a topic for analyses in many years (see for instance Patel (1971) and Morss (1984)). In recent years Helleiner has helped to put such concerns on the agenda again (see, for example, Helleiner (2000)).

3.A realistic analytical perspective on harmonisation and alignment

Increased aid effectiveness is the primary goal of the Paris declaration. The main means to achieve this end is to harmonise donor support and to align it to recipient systems. This raises two analytical issues: how to measure the extent of harmonisation and alignment so that changes can be tracked? And how to analyse the extent to which various policy instruments – such as budget support and decentralised aid management – actually lead to improvements in harmonisation and alignment? These two questions are addressed below. The answers help to build a realistic analytical perspective on harmonisation and alignment issues.

OPERATIONALISING TRANSACTION COSTS AND LOCAL OWNERSHIP

Transaction cost reductions are often regarded as a principal objective of harmonisation and alignment initiatives, but such costs are difficult to define and quantify for at least three reasons.

A range of different activities generates transaction costs. Costs are not just related to the delivery of aid in a more technical sense nor to the costs of its various – including distorting – implications. Costs are also related to such transactions as donor-recipient dialogue, requests for reforms, capacity building, collection and sharing of information, monitoring etc.

Moreover, many stakeholders - both among recipient and donor organisations - incur transaction costs. A number of the activities mentioned above reflect donors' attempts to reduce the risks of aid delivery in situations where donors and the recipient have conflicting preferences, or where donors regard information (for example about the recipient's budget allocations, reporting and accountability systems) as insufficient. Therefore, seen from a donor perspective, costs associated with dialogue, reforms, monitoring etc. are considered as necessary transaction costs, which are difficult to reduce. Recipients may, on the other hand, regard these costs as unnecessary.

Finally, transaction cost calculations are hampered by methodological problems and difficulties in obtaining reliable and quantifiable information. In fact, very few systematic attempts to make explicit and quantifiable calculations have been published. Due to such difficulties most analysts try to identify some overall transaction cost tendencies without specifying in detail how the estimates have been made; or they refrain from relating transaction costs to specific activities (e.g. Amis, Green and Hubbard 2005, p. 373-74). Likewise, few analysts systematically try to

assess or calculate whether a specific harmonisation or alignment initiative have led to transaction cost reallocations between donors and recipients or between different actors on the recipient side³.

One step in making the concept of transaction costs more operational is to distinguish among different types of costs. Thus, a useful distinction has been made between direct and indirect transaction costs, often with focus on the transaction costs of the recipient government (CIEM and JICA 2003; Amis, Green and Hubbard 2005, p. 374; Acharya, Fuzzo de Lima and Moore 2006, p. 6-7; Moss, Petterson and van de Walle 2006).

The direct transaction costs usually include costs incurred in the aid delivery process itself. These can be subdivided into different categories. One typical distinction is between ex ante and ex post costs – understood as the costs incurred before and during implementation (Killick 2004; Martens 2005). This categorisation makes it possible to focus on reallocations between different types of transaction costs (as costs incurred ex ante may lower ex post costs, for example). Furthermore, it can be useful to subdivide the ex post costs into administration, co-ordination and monitoring costs⁴.

The indirect economic costs of aid and aid modalities relate to “Dutch disease” problems, the cost implications of the unpredictability and volatility of aid, and the budget and expenditure composition implications of aid, etc. (see Moss, Petterson and van de Walle (2006) for an overview). Opportunity costs must also be considered as indirect costs when changing aid modalities. These costs can, for instance, be assumed to be larger for senior civil servants in the recipient countries – for instance in Ministry of Finance – than for civil servants in a district.

These distinctions must, however, be used with some reservations. Incomplete information and risks must be dealt with in all phases of the aid delivery process. Donor and recipient responses may therefore not only lead to reallocations of costs between ex ante, ex post and indirect transaction costs but also to shifts within these categories. In addition, the distinctions between the different types of costs can be difficult to make for aid programmes implemented over several phases. Thus, ex post costs in one phase may be considered as ex ante costs for the following phase.

³ Discussions of transaction cost calculation can for instance be found in CIEM and JICA (2003), Killick (2004), Martens (2005), Batley (2005), Acharya, Fuzzo de Lima and Moore (2006), Bigsten (2006), and Clemens (2006).

⁴ This is close to the distinction used in Batley (2005).

Increased local ownership focuses on alignment issues and is the second important goal of the Paris declaration. In general terms, local ownership implies that “partners set the agenda” but what this precisely means has been difficult to specify (Jerve 2002) and various interpretations can be found. The basic idea is, however, that local political priorities guide resource planning and execution in three related ways.

First, ownership implies that the recipient government’s political objectives dominate the development agenda, and that transparent local political decisions are made based on broad involvement and participation of local stakeholders. This requires that government, parliament and other political institutions make decisions about policy and resource allocation serviced and advised by the civil service without distorting donor interference. Second, ownership implies the use of recipient institutions in the implementation of policies. Parallel administrative systems to handle the implementation of donor supported activities – such as donor controlled programme management units - undermine ownership. Finally, local ownership implies the existence of sufficient local institutional capacity to plan and implement the government’s political decisions.

Empirical analyses of the impact of various harmonisation and alignment initiatives on local ownership are, however, complex to carry out. Not only is the ownership concept itself difficult to operationalise. Also information about how aid may actually influence the three dimensions of ownership is difficult to obtain. It requires, for example, an assessment of the implications of aid and aid modalities for the functioning of the recipient country’s political institutions and their decision-making. It also requires assessments of the impact of parallel administrative systems on the capacity of recipient organisations. The latter is, perhaps, the best researched of the three ownership dimensions. Thus, some analyses indicate that local institutions can be undermined by the inflow of donor funds and that this tendency is strongest in aid-dependent countries (e.g. Moss, Petersson and van de Walle 2006). Others argue that the competition between (non-altruistic) donors for the scarce local capacity can also lead to an erosion of recipient country capacity (Knack and Rahman 2004). Unfortunately, these negative effects of aid on recipient capacity may not be outweighed by aid-funded capacity development efforts, and evidence seems to show that the huge amount of aid earmarked for capacity building has not had the intended effect – at least not in Africa (World Bank 2005). In short, local ownership is still constrained by capacity problems.

All this indicates that the mere existence of aid has implications for harmonisation and alignment, and consequently for both transaction costs and local ownership. Likewise, aid modalities have different transaction cost and local ownership implications. Two analytical

perspectives that help to operationalise such implications are presented in the following – the “partnership” and the ‘political economy’ approach.

PARTNERSHIP PERSPECTIVE

Harmonisation and alignment issues are usually discussed in a partnership perspective. Thus much of the official rhetoric around the international harmonisation agenda is influenced by a “feel good rhetoric,” which assumes that all donor and recipient actors share the same objectives based on mutual interest (Cornwall and Brock 2005, p. 1048).⁵

In this perspective harmonisation and alignment are seen as coordination problems between different agents, whose objectives are assumed to be the same, namely to reduce the total transaction costs related to aid administration and to enhance local ownership so that aid becomes more effective in reducing poverty. As the donors do not have conflicting interests, they do not care who supports the individual sectors or act as the lead donor. In other words donors are “altruistic.” It is also assumed that there are no incentive problems that discourage stakeholders to seek to harmonise and align. Likewise, donors are assumed to have more or less complete information about recipient policies, budgets, organisations and capacity. If this is not the case, information sharing or relevant analyses may address the information deficiencies.⁶

Consequently, in the partnership perspective donors can be expected to agree upon the advantages of harmonisation. They will actively try to strengthen coordination with other donors. The “only” challenge will be the practical implementation of harmonisation and alignment initiatives. To facilitate this process recipient countries are encouraged to exercise strong ownership (OECD-DAC 2005c).

The mixed progress of the harmonisation and alignment agenda indicates, however, that this partnership perspective does not provide an adequate analytical framework. This is also implicitly recognised in the documents for the international meetings referred to earlier. Thus, the possibilities of a “tension between partner countries and donors” due to different interests are

⁵ Cornwall and Brock (2005) analyses how terms like “participation”, “empowerment” and “poverty reduction” are used in the international debate to signal optimism and a sense of working for the good. Munro (2005) also emphasizes the importance of language and the arguments used in favour of harmonisation and alignment (see the examples mentioned by Munro (2005, pp. 430-431)).

⁶ Although the concept of “partnership” is used in a number of donor publications, it is rarely defined. In addition, the concept is used both to describe equal and unequal relationships (Johnson and Wilson 2006, p. 71).

mentioned (OECD-DAC 2005a, p. 9). Moreover, “policies and requirements of donors are usually different from each other...” (OECD-DAC 2005b, p. 11). Incentive problems are recognized, too. Inappropriate incentive structures are identified as a major constraint (OECD-DAC 2005b, p. 10; OECD-DAC 2005c, p. 12-13; ODI 2005, p. 6). Donors are therefore encouraged to introduce incentive systems to induce staff behaviour in support of the harmonisation and alignment agenda (OECD-DAC 2005b, p. 10). Finally, it is acknowledged that there is an information problem and sometimes a reluctance to share available information (OECD-DAC 2005b, p. 14).

However, recognition of such problems of the partnership perspective has only marginally influenced the actual analyses of implementation problems and policy options. A more appropriate analytical framework for analyses of the challenges to the harmonisation and alignment agenda is therefore required.

POLITICAL ECONOMY PERSPECTIVE

Most aid practitioners and development researchers agree that the basic assumptions of the partnership perspective are unrealistic. First, it is well-known that recipient countries do not always share the objectives of the donors. Many failed attempts to introduce conditionalities clearly document this. Although the use of such conditionalities has changed, more recent efforts to strengthen the so-called policy dialogue with the recipient countries, for instance by decentralising the aid administrations, reflect a continued ambition to influence recipient policies. That donors’ preferences differ and that donors have different motivations for giving development assistance is also well-documented. Some donors prioritize humanitarian and poverty outcomes, while others are more motivated by economic and political interests (Roodman 2005). In addition, donors often seek to use aid in non-altruistic ways: to buy support and goodwill in international fora; to meet aid disbursement targets; to help to promote donors’ commercial interests (tied aid) and exclude those of competitors; to cater for special-interest home constituencies (including NGOs), often resulting in the pursuit of multiple and often conflicting objectives; to assure visibility of aid funded activities (‘raising a flag’, ‘setting a fingerprint’) to attract political attention at home; and to improve the accountability of aid to donor country taxpayers. All this indicates that donors are “non-altruistic:” the individual donor

places a higher weight on the success of own-funded projects than on projects funded by other donors⁷.

Second, several analysts have dealt with the importance of the incentive structures both on donor and recipient sides⁸. The donor government and its aid bureaucracy do not necessarily have the same interests. The traditional argument here is that donor agencies have objectives like maximising their budgets. Due to the non-altruistic behaviour of donors there could also be a discrepancy between what donor agencies say and do. Thus, donors could participate in the international “feel good rhetoric”, but at the same time maintain a strong individual profile in the recipient countries.

Individual staff within stakeholder organisations may also have interests that differ from those of the organisation they work in, and these interests can obviously be guided by many other factors than conclusions from international meetings in which recipients and donors agree to harmonise and align. It is, for example, well known that staff members can have personal interests, which differ from the expressed interests of their organisations. An altruistic perspective may guide donor staff even when their government pursue non-altruistic policies. Conversely, donor staff may try to be visible to further their own career instead of engaging in close donor harmonisation and delegation etc. If visibility is important, decentralised donor staff may not have a strong incentive to build up recipient country capacity or to reduce the administrative burden on the recipient side.

That recipient stakeholder interests are not aligned either is also well-known⁹. Sector ministry interests can differ from the interests of Ministry of Finance, civil servants’ from government’s, citizens’ from government’s etc. In addition, different strategic alliances can be established between donors and recipient actors. For example, some civil servants are on contract with the donors and benefit in different ways from donor assistance. Consequently, they have an interest in protecting the various aid projects instead of pushing for a less fragmented donor assistance (Knack and Rahman 2004, p. 4). This has also been noted for Mozambique: “Donors, sector

⁷ The interesting recent discussion on whether donor competition is useful or not will not be dealt with here, but see Birdsall (2005), Klein and Harford (2005), Easterly (2006).

⁸ An analytical framework is provided by Martens et al (2001). Analyses and discussions of donor staff incentives can be found in Ostrom (2002) and ODI (2005).

⁹ See for instance Killick (1997, p. 488): “This fragmentation may sometimes render it misleading to analyse them as single decision units”.

ministries and public agencies have implicitly colluded in guarding their own funding ... “ (Batley 2005, p. 418). In such situations civil servants do not have clear incentives to support more budget support and donor harmonisation for this may threaten some of the advantages that fragmentation bestow on individual civil servants.

Third, there is incomplete and asymmetric information not only about the objectives, strategies and incentives of other actors, but also about budgets, timing etc. Such problems may diminish when donor funded activities continue for several years but recurrent changes in donor and recipient formal and informal policies, incentives and budgets contribute to make the information problems perennial. Incomplete information influences both donor-donor and donor-recipient relationships. In such situations actors will be prepared to incur transaction costs in order to obtain relevant information and to reduce uncertainty, but their efforts (and costs) will, of course, differ (Martens 2005, p. 645).

Finally, neither donors nor recipients are single uniform actors. Consequently it is important to consider not only the total transaction costs but also who bears them and whether cost reallocations among stakeholders take place when aid modalities change. Similarly it is important to explicitly consider the differential implications for recipient stakeholder ownership of changing aid modalities

To summarise, in the political economy perspective it is assumed that differences in preferences among stakeholders exist; that various stakeholders have different incentives to pursue a harmonisation and alignment agenda, and that lack of information about strategies, interests, budgets and so on can seriously affect this agenda. This is consistent with empirical evidence and thus gives a better basis for analysing donor harmonisation and alignment issues than the partnership perspective does.

4.A political economy analysis of budget support and decentralised development administration

The following analyses present an assessment of the impact of budget support and decentralised aid administration on transaction costs and local ownership based on a political economy perspective. The results can be rather different than those generated through a partnership perspective.

Assessments of the actual implications of the two instruments for transaction costs and local ownership depend, however, on the specific design of harmonisation and alignment initiatives and the context in which they are implemented (e.g. the degree of trust between recipient and donors; how the donor collaboration is organised in the recipient country; the degree to which new initiatives like joint assistance strategies, donor concentration efforts, delegated partnerships, lead donor models are pursued; etc).

Such country specific analyses are beyond the scope of this paper. Instead, typical responses of donors and recipients to the implementation of budget support and decentralisation of aid administration are identified, and the transaction costs and local ownership implications of these responses analysed. The assessments below of the two instruments are therefore generic.

TRANSACTION COST IMPLICATIONS OF BUDGET SUPPORT AND DECENTRALISED AID ADMINISTRATION

Increased use of budget support combined with decentralised aid administration will lead to lower transaction costs. That is the prevailing view based on the partnership perspective. The argument is that budget support reduces the number of transaction cost intensive donor funded projects and programmes, which each has their own donor specific organisational arrangements, reporting systems and so on. In addition, decentralised aid administration will lead to reduced transaction costs for two reasons. First, decisions can be taken locally and quicker than in the past, where many issues were dealt with at donor headquarters level. Second, the quality of the decisions improves as the donors get a better local knowledge through the so-called local policy dialogue.

From a political economy perspective things typically look different. More specifically, budget support may result in high transaction costs because donors regard it as a more risky and less visible aid modality than project and sector programme aid.¹⁰ In response, donors often request for more dialogue and information during aid negotiations, and for closer monitoring during implementation. Furthermore, budget support requires better coordination among donors, and donor negotiations on how to collaborate have shown to be demanding in terms of time and resources. In principle, decentralised aid administration makes it easier for donors to improve coordination, but the non-altruistic donor behaviour often leads to relatively transaction cost intensive responses, which may outweigh the savings arising from the reduced number of

¹⁰ Although the outlined political economy perspective could contribute to an explanation of the existing relative low level of budget support this is not part of the purpose of this paper.

financial transfers that budget support entails. These general tendencies can be assessed within the framework of ex ante, ex post and indirect costs of activities proposed earlier.

First, consider the ex ante activities related to budget support and decentralisation that incur 'extra' transaction costs. As already mentioned, budget support has increased donor demands for consultations and policy dialogue with recipient governments (Batley 2005, p. 420), and numerous studies and extensive negotiations are often carried out before budget support programmes can start their implementation. Moreover, the international harmonisation and alignment agenda has in itself led to more collaboration between donors and recipients, and local budget support donor groups with relatively frequent meetings have been established in a number of countries. They are generally assumed to reduce the transaction costs, but this assumption often ignores the costs associated with setting up these donor groups, and that donors wish to get access to information and to reduce the risks associated with budget support by being very closely involved in its design. There is little doubt that this implies significant ex ante costs for donors.

The donor demand for dialogue, negotiations and information has also increased ex ante costs on the recipient side. Here it is typically the Ministry of Finance that plays a key role in the budget process, but also sector ministries and sometimes district level staff are involved. The budget support therefore entails not only significant recipient ex ante costs, but also a reallocation of transaction costs on the recipient side as discussed further below.

Second, consider ex post activities related to budget support and decentralisation that incur 'extra' transaction costs. During implementation it is likely that some administration transaction costs will decline (because budget support replaces project and sector programme support), while coordination and monitoring costs may be considerable. That transaction costs related to coordination and monitoring may be significant during programme implementation is no surprise. Thus, it is plausible that the non-altruism of donors and their focus on risk reduction have encouraged the decentralisation of aid administration, which makes it possible to be more active on the ground on a continuous and regular basis. Thus, in Vietnam, for example, it is reported that "at least 19 thematic working groups as well as 24 sector partnership groups" have been created (OECD-DAC 2005a, p. 136)¹¹. To this should be added the recurrent informal contacts between donors and recipients, which has probably also increased after decentralisation.

¹¹ A discussion of harmonisation and alignment in Vietnam can be found in Bartholomew and Lister (2005), where the number of working groups is explained by lack of trust in the Vietnamese institutions.

This proliferation of groups illustrate that most donors wish to participate actively in donor coordination and to maintain an individual donor profile. In addition, it seems that career prospects for donor staff are improved by an active participation in the local donor collaboration. Such incentives may result in permanently high transaction costs (ODI 2005).

Certain recipient government staff incentives may also reduce their motivation for contributing to harmonisation and alignment objectives during implementation. There are, for example, obvious personal interests in working in donor supported project and programme management units – and on earmarked donor funded activities in general – because of the higher salaries and fringe benefits that are often provided in these arrangements. From this personal perspective, the introduction of budget support and related donor harmonisation and alignment can be a threat to the interests of these staff groups with the consequence that transaction cost reducing measures can become more difficult to implement.

Third, consider the reallocation of costs related to budget support and decentralisation. Such reallocations of transaction costs between recipients and donors do take place when introducing more budget support. It could be argued that higher donor transaction costs should not be considered as a problem if recipient transaction costs are reduced. Unfortunately that is not necessarily the case. The recipients' transaction costs can increase as a consequence of transferring more ownership to the recipients. The reason is that when project aid was the preferred modality, recipient direct transaction costs were relatively low as donor (funded) staff mainly ran such projects outside the government administration. In contrast, budget support is demanding on recipient organisations in terms of direct transaction costs as shown above. In particular, the Ministry of Finance, as already mentioned, is typically faced with much more work in all phases of the budget support process as it is typically given a central role in the donor-recipient dialogue. Moreover, donors often request the partner country to participate in the local coordination groups at senior level. This implies that key staff spends a considerable time interacting with donors.

Finally, consider the indirect transaction costs arising from harmonisation and alignment activities. Indirect economic transaction costs will probably be reduced significantly as a consequence of budget support, and this is often used as the main argument for providing more budget support. The reason is that, in principle, budget support makes it possible to budget for all available resources (see the assessment of ownership below)¹². This depends, however, on a

¹² See also recent OECD-DAC budget support evaluation (OECD-DAC 2006).

number of assumptions including that the budget support in question is relatively stable and predictable. Available evidence suggests that this is not always the case (Bulir and Haman 2001).

LOCAL OWNERSHIP IMPLICATIONS OF BUDGET SUPPORT AND DECENTRALISED AID ADMINISTRATION

From a partnership perspective increased budget support will lead to more local ownership, as this modality will result in more local control and more transparent policy decisions. A further argument is that this will not only apply for aid funds, but also for the recipient government's own funds, which will be merged with the aid funds in the budget. A more transparent and better-managed public sector based on recipient priorities will result. Local ownership will also be enhanced by decentralising the aid administration, because it gives recipients easier access to the donors so that decisions can be taken faster without waiting for donor headquarter approval. This conclusion is, however, based on the assumption that donors and recipients share the same objectives, that donor staff has incentives to help to strengthen local ownership, and that information problems can be solved through harmonisation and alignment.

In a political economy perspective the impact on the three earlier mentioned dimensions of local ownership of budget support and decentralised aid management are more ambiguous as shown below.

First, consider the implications of budget support and decentralised aid administration for political ownership. Budget support is usually provided for the implementation of the PRSP. If this programme reflects local political priorities and is "owned" by the recipient country, budget support will in principle strengthen local ownership compared to project aid, as the latter often bypassed local political institutions and was given in uncoordinated ways. Analyses of various PRSPs have, however, questioned the strength of this ownership (Booth 2003). Moreover, donors tend, as already mentioned, to try to influence recipient policies and use budget support to ensure this influence either as a group or individually. It is not always clear how this dialogue is coordinated with the political representatives of recipient countries. An active donor group may therefore out-compete local politicians in the budget process so that the domestic political process is undermined. Assuming that a recipient government wants to counteract this undermining of its political institutions, it will have little incentive to strengthen harmonisation and alignment. To this can be added, that budget support is documented to be more unpredictable and volatile as already noted. This can make it relatively difficult to exert local ownership over budget planning and execution.

Decentralised aid administration may contribute to weaken local ownership too. Thus, the increasing emphasis placed on the “policy dialogue” is not just related to coordination, but also to political influence and access to information, which the political economy perspective assumes is important in order to reduce the risk of budget support programmes. The donor-recipient dialogue is now typically organised through a significant number of donor groups - which, at least partly, has reduced the previous large number of missions - but these groups place a heavy burden on an often limited recipient capacity and makes it difficult for the recipient country to take the full ownership. In addition, the degree to which donors have actually become more flexible and able to react faster to recipients’ needs after decentralisation of donors’ administration is not clear and deserves more analysis.

Moreover, the enhanced local presence of the donors opens up for various strategic alliances, between groups of donors, between individual donors and between donors and segments of the central government in the recipient country, line ministries etc. (Therkildsen 2000). The basis for these alliances will be joint interests. They can lead to sharing of information, but also to a reduction of ownership. For example, donor and ministry staff may collude to further specific activities of interest to both parties, but not necessarily to other donors or to the political authorities in the country.

Second, consider the implications of budget support and decentralised aid administration on administrative ownership. It is an integral part of the budget support modality – and a key argument in its favour - that local institutions and procedures are utilised in aid delivery. This actually happens in practice so that the aid funds to a larger extent than hitherto are channelled through the recipient’s organisations and its administrative system, rules and regulations. This has reduced the use by donors of parallel implementation structures (e.g. project and programme implementation units). As a consequence this administrative dimension of local ownership will be strengthened by an increased use of budget support.

Finally, consider the implications of budget support and decentralised aid administration for the capacity to take on local ownership. Sufficient political and administrative capacity is a necessary, but not a sufficient, condition for meaningful local ownership. For without adequate capacity recipient countries cannot carry ownership responsibilities in a meaningful way. Thus, the proclaimed desirability of alignment is in conflict with the reality of insufficient capacity (as judged by donors). In fact, the formation of many donor groups and the close donor follow up on budget support is often explained by low recipient capacity. Capacity development is an obvious response to this problem, but as mentioned earlier, it is debatable whether the substantial donor support for this has been successful.

5. Conclusions

The Paris declaration of 2005 is now regarded as the key document in international efforts to improve aid effectiveness. Its key argument is that transaction costs of providing and receiving aid must be reduced and that local ownership of such aid must be enhanced.

To achieve this, more use of budget support and decentralised aid administration to donor offices located in the recipient countries are considered important. But the implementation of such measures often face considerable practical and political problems as the analyses in this paper show. In addition, there are conceptual and measurement problems in making reliable estimates of changes in transaction costs and local ownership when aid modalities and aid management practices change. More specifically, the analyses in this paper point to four major conclusions.

First, the gap between rhetoric and practice in recent efforts to harmonise donor support and align it to the policies, institutions and capacities of recipient countries is often considerable. These difficulties are glossed over in the so-called “partnership” approach of the Paris declaration, which makes rather unrealistic assumptions about donor and recipient government interests in harmonisation and alignment; about donor and recipient staff incentives to actually work to improve harmonisation and alignment; and about the degree of complete information or willingness of the involved parties to share and exchange information to facilitate harmonisation and alignment. Therefore divergent interests of governments, weak or inappropriate incentives for staff, and non-altruistic use of information must be fully embraced in analyses of harmonisation and alignment efforts to be useful. The “political economy” approach proposed in this paper is based on this more conflictual – but also more realistic - view of the donor-recipient relationship.

Second, because of such conflicts there are no simple and unambiguous relations between budget support, decentralised aid administration and aid effectiveness. It cannot be taken for granted, for example, that lower transaction costs will result from “economies of scale” benefits of budget support and from the closer working relations between donors and recipients that decentralised aid administration entails. Indeed, even if such costs do decrease overall, some recipient stakeholders may actually experience increased transaction costs. The incidence of transaction costs changes is therefore important to consider in addition to the aggregate trends.

Nor can it be taken for granted that budget support and decentralised aid administration will enhance local ownership. While administrative ownership is probably enhanced by these measures, there are many indications that political ownership is not because budget support agreements are often made without much involvement of the relevant recipient political institutions. Certainly, a single large budget support arrangement has a risk structure, which deviates fundamentally from the risks associated with a number of small donor funded projects. Donors often react to this risk in ways that do not enhance local ownership.

The bottom line is therefore that the actual impact of budget support and decentralised aid administration on transaction costs (and who bear them) and on local ownership depends on the country-specific context in terms of donor-recipient interests, incentives and altruism. This also implies that how donors organise themselves and how the donor-recipient collaboration is organised and implemented are of central importance.

Third, lower transaction costs and enhanced local ownership may be desirable in principle, but those principles should not be pursued too single-mindedly. Transaction costs reductions are not necessarily a desirable general goal and as indicated there need not be an ambiguous relationship between transaction costs and aid effectiveness. Aid effectiveness may even suffer if transaction costs are reduced too much. Some transaction costs are simply central to an effective delivery of aid. Local ownership, likewise, needs to be considered in context. The dilemma is that legitimate interests of donors may differ from those of representatively and democratically elected recipient bodies.

Finally, the analyses presented here illustrate that the concepts of transaction costs and local ownership are far from precise and empirically operational. Despite the substantial interests in these concepts – and their importance for current aid policy - surprisingly few attempts to measure them in specific contexts and for specific aid modalities exist. And those attempts that have been made are rather rudimentary. There is therefore an urgent need to address the conceptual and empirical issues raised by the Paris declaration.

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