

MASTER'S THESIS
INTERNATIONAL ADMINISTRATION
AND GLOBAL GOVERNANCE

Does Institutional Quality Determine Aid Allocation?

A Cross-Country Approach to General Budget Support:
Do Donors Practice What They Preach?

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Abstract

This thesis seeks to address the allocation of development aid in relation to institutional quality of recipient countries by focusing on General Budget Support (GBS) – an aid modality associated with increased aid effectiveness and un-earmarked funds to recipient governments that display high institutional quality, but also with risks of moral hazard. The thesis departs from a theoretical framework based on previous research concerned with aid allocation and an on-going debate on aid effectiveness taking place within main donor organizations. On the one hand, aid effectiveness could theoretically be enhanced when aid is allocated in the form of un-earmarked funds, allowing for recipient governments to pursue their own policies and decrease the transaction costs often associated with aid. On the other hand, previous research indicates that donors may allocate aid based on strategic self-interest rather than altruism and the performance of recipients, and associates aid-inflows with risks in the form of moral hazard and misuse of funds. In relation to GBS, these two theoretical strands can be seen as somewhat conflicting. Is GBS only allocated to recipients with high institutional quality, as often claimed by donors? Similar to other sources cited in this thesis, a quantitative, cross-country approach is adopted. Departing from a dependent variable measuring GBS provided by the European Union within the framework of the Cotonou Agreement, OLS regressions are used. Three features of institutional quality are used as independent variables. The results obtained do not indicate that the institutional quality of recipients determines the allocation of GBS.

Key words: Aid effectiveness, institutional quality, General Budget Support

Number of words: 17 115

Abbreviations

ACP	African, Caribbean and Pacific countries
CRS	Creditor Reporting System
DAC	Development Assistance Committee
EC	European Commission
ECD	European Consensus on Development
EU	European Union
EDF	European Development Fund
GBS	General Budget Support
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
ICRG	International Country Risk Guide
IMF	International Monetary Fund
MDG	Millennium Development Goals
NGO	Non-Governmental Organization
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OLS	Ordinary Least Squares
PFM	Public Financial Management
PRS	Poverty Reduction Strategy
PDAE	Paris Declaration on Aid Effectiveness
PRS	Poverty Reduction Strategy
QoG	Quality of Government
SBS	Sector Budget Support
UN	United Nations
WGI	World Governance Indicators

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1. Introduction and purpose statement

Every year, vast sums of development aid are provided by bilateral and multilateral donors to recipient countries and organizations. At the present, more than 150 billion US dollars per year is allocated, and the size of the yearly amounts has lately increased each year (OECD, 2011a).¹ Increased aid flows can be seen as necessary in order to eradicate poverty (Sachs et al., 2004). At the same time, aid can also be associated with a number of problems. Its effects have been questioned, and it has also been associated with risks in the form of moral hazard, corruption and distorted incentives for recipient governments to be accountable towards their citizens (Bräutigam, 2000; Bräutigam & Knack, 2004; Djankov et al., 2008; Goldsmith, 2001; Knack, 2001; Tavares, 2003). The impact of aid has been recognized to depend on the institutional quality – often discussed in terms of growth-fostering rules, control of corruption, level of democracy and regulatory quality – of recipient countries (Burnside & Dollar, 2000; Ear, 2007; Easterly & Pfutze, 2008; Wright, 2009). Following this line of thought, higher institutional quality of a recipient country is associated with higher probability for positive impact of aid. Conversely, aid allocated to recipients with weak institutional quality can be associated with higher risks in terms of corruption, which in turn may decrease the probability to achieve desired results.

The notion of institutions in relation to aid has lately also gained increased attention by the donor community (OECD DAC, 2006a, 2012d). Outcome documents from a number of high level meetings, not least the Paris Declaration on Aid Effectiveness, have included commitments towards increased focus on recipient institutions in order to achieve improved results of aid resources spent (United Nations, 2003a, b; OECD DAC, 2005, 2008b, 2011, 2012c). In line with the Paris Declaration on Aid Effectiveness, donors have recognized that aid channelled through recipients' own financial systems can enhance aid effectiveness – meaning “ensuring that development resources have the greatest impact on development” (OECD DAC 2012b) – when allocating development aid. This is said to allow for recipient governments to pursue their own policies and thereby increase their capacity (OECD DAC, 2006a). This notion is central for an aid modality called General Budget Support – un-earmarked financial resources provided directly to a recipient's national treasury (OECD DAC, 2006c). Theoretically, the provision of un-earmarked financial resources is said to

¹ Search in OECD Country Reporting System database conducted the 12th of May 2012, current prices.

reduce donor-driven administration costs as well as improve the capacity of recipient governments to formulate and fulfil their own strategies for poverty reduction. Donors stress that General Budget Support is to be provided to “good performers” – recipients with high institutional quality – in order to ensure a positive impact and reduce the risks of misuse of funds provided (Koeberle & Stavreski, 2006; Gunning, 2006). This is well in line with the notion that aid should be allocated to recipients with high institutional quality. However, no fixed eligibility-criteria for allocation of General Budget Support exist. Donors motivate this by stressing that General Budget Support sometimes also can improve the institutions of a “poor performer” (OECD DAC, 2006e).

The claim to allocate General Budget Support to “good performers” in combination with the lack of fixed eligibility criteria can be seen as interesting in relation to the previous research that indicate that donors may allocate aid based on factors such as strategic interests and historical relations with recipient countries rather than poverty alleviation (Alesina & Dollar, 2000; Collier & Dollar, 2002; Neumayer, 2003; Easterly and Pfutze, 2008; Schraeder et al., 1998). How is General Budget Support allocated?

Central to the problem formulation of this thesis is thus the lack of clear allocation criteria of General Budget Support combined with the potential risks of misuse of aid resources and the previous research indicating that donors may allocate aid first and foremost based on their own strategic priorities.

The purpose of this thesis is therefore to examine to what extent donors actually practise what they preach and allocate General Budget Support to recipient countries with high institutional quality. Do recipient countries with higher institutional quality receive higher amounts of General Budget Support, and vice versa? Departing from a policy-based discussion on aid effectiveness and a considerable body of research addressing the motives behind aid allocation, this thesis thus seeks to shed light on the role of institutional quality in relation to the allocation of a specific type of aid that can be seen as particularly interesting in relation to institutional aspects of recipient countries.

Similar to many publications cited in this thesis, a quantitative, cross-country approach – mainly Ordinary Least Square (OLS) regressions – is adopted. Where previous research mainly departs from the wide, loan-including definition of aid as ODA, the results presented

in this thesis are based on a dependent aid-variable comprising of flows of General Budget Support only. The data on General Budget Support is extracted from the Organization for Economic Cooperation and Development's Development Assistance Committee's (OECD DAC) Creditor Reporting System (CRS) database.

Whilst the theoretical advantages of aid effectiveness and General Budget Support can be said to be recognized by the donor community in general, this thesis focuses on the General Budget Support provided by the European Commission financed by the member states of the EU within the framework of the Cotonou agreement, which provides the fundament for the relationship between the EU and 78 countries in Africa, the Caribbean and the Pacific. Together, the EU and its member states comprise the world's largest provider of aid. Hence, focusing on the EU can be seen as motivated given its leading role within the donor community. Furthermore, the EU can be seen as representative for the donor community given that the Commission, like other main donors, adhere to the principles of the Paris Declaration of Aid Effectiveness that emphasizes the need for allocating aid through recipient systems in order to enhance aid effectiveness (OECD DAC, 2005).

Departing from previous research, three measures of institutional quality – control of corruption, rule of law and level of democracy – obtained from the Quality of Government dataset (Teorell et al., 2011) are used as independent variables.

The results obtained indicate that the institutional quality of recipient countries does not determine the allocation of General Budget Support. No significant relationship between institutional quality and the allocation of General Budget Support is detected. This result is maintained when population and infant mortality are controlled for. Seen as groups, the countries that receive General Budget Support do not display significantly higher institutional quality than the countries that do not receive General Budget Support although the countries of the two groups all have signed the Cotonou agreement, which stipulates common allocation criteria for its signatories. The thesis finally seeks to analyse the results obtained in relation to previous research and the rationale of aid effectiveness.

2. Theoretical framework

According to Alesina and Dollar (2000), the literature on foreign aid can be divided in two parts: one concerned with the effects of foreign aid in recipient countries and the other concerned with how and why donors allocate foreign aid. Although the focus of this thesis is on the latter, these two fields of research can be seen as interlinked. Hence, they are both addressed in this thesis. This chapter provides the theoretical foundation of the thesis and rests upon two “pillars” – one based key policy documents and evaluations of General Budget Support issued by major donor agencies such as the OECD DAC and the World Bank, and the other based on previous research and empirical findings related to aid and institutional quality. The theory section seeks to shed light on issues related to aid allocation and institutional quality in general and in relation to General Budget Support in particular. Finally, the section motivates why the purpose of this thesis is important from policymakers’ as well as from researchers’ point of view.

2.1 Defining aid

Broadly speaking, aid can be seen as all resources transferred by “donors” to “recipients” (Riddell, 2007). According to Riddell, the definitions, roles and motives of donors and recipients may vary, as well as the modalities and results achieved. The very notion of “foreign aid” or simply “aid” may thus imply different interpretations. It can be related to different contexts and political objectives, from pursuing interests of donors during the Cold War to the achieving of the Millennium Development Goals (MDG) in the 21st century. Its origin may be traced back to the late 1940s and the implementation of the Marshall Plan (Bräutigam & Knack, 2004) or to the resource-flows to British and French colonies in the early 20th century (Riddell, 2007). Thus, the notion of aid may denote different purposes as well as providers - from official development aid for long-term development to humanitarian and emergency aid to meet acute needs, provided by governmental organizations as well as non-governmental ditto. Riddell discusses these different connotations in terms of three different “aid-worlds”, where official aid is accompanied by non-official aid and humanitarian aid. The concept “aid” is thus complex. Recognizing the potential magnitude of the concept and following the discussion of Riddell, this thesis is mainly concerned with issues related to aid provided from “rich” official donors to “poor” recipients, with the purpose of promoting human welfare and reduce poverty.

For the sake of this thesis, measures of aid-flows will depart from Official Development Assistance (ODA), which is used as a measure of aid in most research on aid cited in this thesis (for instance Alesina & Dollar, 2000; Alesina & Weder, 2002; Boone, 1996; Bräutigam, 2000; Bräutigam & Knack 2004; Charron 2011; Collier & Dollar, 2002; Djankov, Montalvo & Reynal-Querol 2008; Dollar & Levin, 2006; Dunning 2004; Ear 2007; Goldsmith 2001; Knack, 2001; Knack 2004; Sachs et al 2004; Schraeder, Hook & Taylor 1998; Svensson, 1999; Wright 2009; Wright 2011).²

The Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD DAC), which can be seen as the main donor-organization, defines ODA as transfers of resources in the form of cash, commodities or services that have three central features: Firstly, each transaction has to be provided by "official agencies, including state and local governments, or by their executive agencies". Secondly, a transaction has to be "administered with the promotion of the economic development and welfare of developing countries as its main objective". Thirdly, it has to be "concessional in character and convey a grant element of at least 25 per cent". In addition, the recipient of ODA has to be on the OECD DAC list of ODA-recipients. Central to ODA is the notion of addressing economic development and welfare through the public sector of a developing country (OECD DAC, 2008c, p. 1-4). Besides from the recipients on the DAC list, transfers to a number of multilateral agencies may count as ODA, including those to many United Nations agencies, the European Commission (EC), the European Development Fund (EDF) and various World Bank and IMF-agencies (OECD DAC, 2010). ODA-funds are authorized by donor parliaments, most commonly on an annual basis (Riddell, 2007). Over the past 50 years, ODA-flows have been estimated to 2.3 trillion US dollars (Easterly & Pfütze, 2008).

Following this, aid is thus to be seen as ODA and "aid allocation" as the provision of aid from a donor to a recipient. In the context of this thesis, a donor is to be seen as a bilateral or multilateral provider of aid. A recipient is the country who receives aid.

² The academic sources cited in the thesis discuss ODA in terms of aid, development cooperation, development aid and foreign aid. Given that a nomenclature-based discussion is not the primary purpose of this thesis, the concepts of "aid" and "development aid" are mainly used due to their predominance in cited research.

Admittedly, ODA may be seen as an imperfect measure of aid, neglecting aid-efforts by Non-Governmental Organizations (NGOs) and including the aid-administration of donors as well as the funds reaching the recipients (Riddell, 2007). However, given its predominance in previous research and the availability of data, ODA-based research is seen as a relevant point of departure for the purpose of this thesis. In turn, the aid-modality central to this thesis – General Budget Support – is to be seen as a specific and narrower type of ODA (OECD, 2011a). Or put in another way: General Budget Support is ODA, but all ODA is *not* General Budget Support.

2.2 General Budget Support

The type of aid called Budget Support can be defined as “a method of financing a partner country’s budget through a transfer of resources from an external financing agency to the partner government’s national treasury” (OECD DAC, 2006a, p. 26). Budget Support can in turn be divided in the sub-categories of *General* Budget Support and *Sector* Budget Support (SBS), whereas the former refers to contributions to the overall budget and the latter to aid earmarked for discrete sectors of the budget (Koeberle & Stavreski, 2006; OECD DAC, 2006a). Regardless the similarities between these two types of budget support, the focus of this thesis is mainly on *General* Budget Support.³

General Budget Support can in turn be defined as “aid to governments that is not earmarked to specific projects or expenditure items” (OECD DAC, 2006b, p. 1). It is channelled through the recipient government’s own financial management system and is thus mixed with the recipient government’s own revenues. For the purpose of this thesis, General Budget Support is defined according to the OECD DAC CRS-database as “un-earmarked contributions to the government budget” (OECD, 2011c, p. 21).⁴

Different donors tend to differ slightly in their definitions of Budget Support, but the notion of direct financial support to a country’s budget for the purpose of recipient-led poverty reduction is always central to the concept (Koeberle & Stavreski, 2006; Hammond, 2006). Budget Support can therefore be seen as a shift from “traditional” project-based development aid to a more effective way of providing assistance that is in line with principles of

³ Some sources cited in this thesis only use the overarching concept of Budget Support (sometimes also labelled Direct Budget Support, DBS) and thus do not emphasize the distinction between GBS and SBS. When GBS is not explicitly used by a source cited, this is marked with the use of Budget Support instead of GBS.

⁴ Purpose code 51010 of the OECD DAC Country Reporting System.

partnership as stated in the Paris Declaration on Aid Effectiveness. Where previous forms of development aid have been based on donor conditions, budget support can be seen as a new approach to conditionality as the conditions are jointly agreed upon before funds are disbursed (Williamson, 2006). Budget Support thus does not imply that the conditionality has disappeared completely, but rather transformed to reward “good performance” of recipients (Gunning, 2006). Theoretically, donors are to provide Budget Support when recipients can display that they live up to a number of conditions before the aid is transferred.

Koeberle and Stavreski (2006) have identified a number of key differences between Budget Support and “traditional” development aid, illustrated by the figure below.

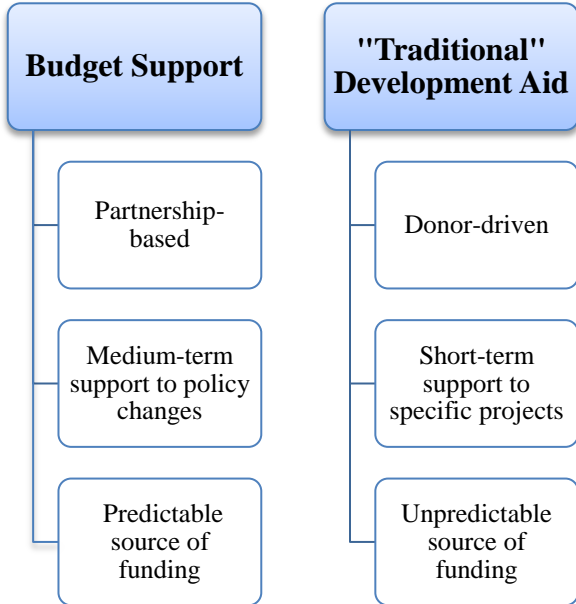


Figure 1. Characteristics of Budget Support compared to “traditional” development aid.

According to OECD DAC, the notion of un-earmarked aid through government budgets should not be seen as a completely “new” phenomenon as it has been used before, for instance in the form of debt relief and structural adjustment lending. However, General Budget Support is seen as different from such approaches as it is designed to support nationally formulated – and thereby “owned” – Poverty Reduction Strategies (PRS). By supporting strategies as such, the ownership of recipients – and thereby the effectiveness of aid – can be increased (OECD DAC, 2006b).

General Budget Support can thus be seen as a way to strengthen national capacity of recipients and thereby ensure more efficient poverty reduction. Like World Bank-officials Koeberle and Stavreski (2006), an OECD-issued joint evaluation states that General Budget Support can be contrasted to the aid-approaches of the era of structural adjustment that imposed external solutions through donor-driven conditions (OECD DAC, 2006b). General Budget Support, with its focus on the recipients' agenda, can therefore be seen as a contemporary approach to aid. Emphasizing the influence and capacity of the recipient, the focus on results and increased aid effectiveness, these features embody the core principles of the agenda for aid effectiveness.

The function of General Budget Support in relation to the agenda of aid effectiveness is illustrated by the figure below.

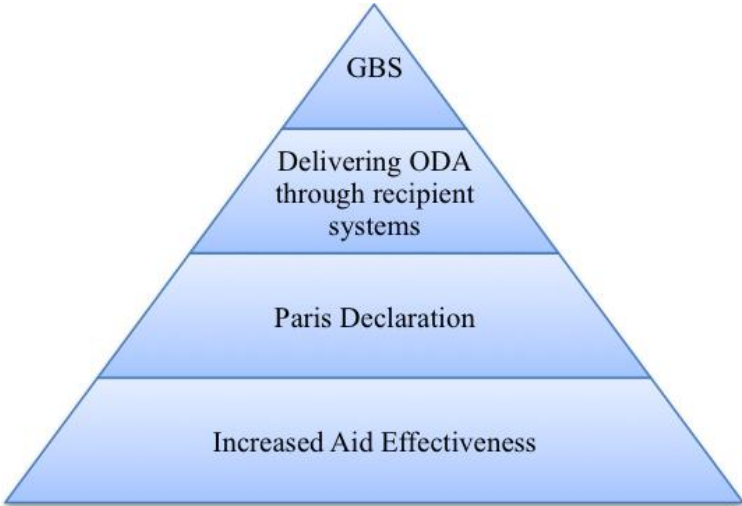


Figure 2. General Budget Support in relation to the agenda of aid effectiveness.

2.2.1 Who provide General Budget Support?

OECD DAC has stated that delivering aid through recipient Public Financial Management (PFM) systems should be at the core of donor development strategies (OECD DAC, 2006a). In line with this statement, the potential of Budget Support has been recognized by many multilateral development organizations including various United Nations agencies, the World Bank and the European Commission (OECD DAC, 2006a; United Nations, 2010; European Commission, 2010a, b). It has also gained increased attention in the bilateral efforts of national governments that are pursuing the aid effectiveness agenda set out in the Paris

Declaration on Aid Effectiveness (Hoven, 2006; Amin, 2006; NORAD, 2006; Arakawa, 2006; Sida, 2011).

Among national governments, the United Kingdom, Sweden, Finland and the Netherlands have the largest share of General Budget Support relative other forms of development assistance (Strategic Partnership for Africa, 2009). In 2009, total commitments on General Budget Support-flows made by all donors reached almost 5 billion US dollars. Of these commitments, about two thirds were made by bilateral donors and one third by multilateral ditto (OECD 2011a).⁵

2.2.2 Expectations, effects and experiences – rewards and risks

The various dimensions of General Budget Support can be divided into a basic framework of “inputs” and “outputs”. Somewhat simplified, inputs refers to the disbursement of funds and outputs to the outcomes achieved (Hammond, 2006; Lawson et al., 2006). This distinction resembles the ditto outlined in the forthcoming section of previous research.

Theoretically, General Budget Support is associated with a number of advantages and benefits. By emphasizing the recipient government’s poverty reduction-agenda and delivering it to the national treasury, the method is recognized to hold the potential to improve the quality of the recipients’ institutions, decrease the transaction costs that often are associated with “traditional” forms of development aid and increase the predictability of aid-flows and thereby facilitate recipient government budgetary planning. These features can all be connected to improved poverty reduction and reaching the Millennium Development Goals (OECD DAC, 2006a, 2012d). The ownership-dimension also enables a potential to address crosscutting issues in the fields of public sector reform and improvements in governance in recipient states. By emphasizing recipients’ priorities and enabling increased government spending, General Budget Support can promote recipient government accountability – to its taxpayers as well as to donors (OECD DAC, 2006d, Koeberle & Stavreski, 2006). The method is also associated with non-financial inputs, such as policy-dialogue between donors and recipients (Williamson, 2006).

Although many advantages have been recognized, the effects of General Budget Support are seen as hard to measure given that the method can be seen as relatively new and evaluation

⁵ 2009 constant prices. Search in OECD StatExtracts-database conducted 2012-04-07.

findings are hard to generalize. The OECD joint evaluation of the method states that the effects depend on the recipients' PRS and that it can be hard to separate the effects of General Budget Support from the ditto of other aid-flows (OECD DAC, 2006d).

Despite the difficulties of measuring the effects of General Budget Support, recent donor evaluations give support to some of its positive connotations. For instance, General Budget Support has been shown to allow recipient governments to increase expenditure in priority areas such as health and education, formulate better poverty-focused policies and perform better on the MDG (National Audit Office, 2008; Alonso, Judge & Kluman, 2006; Beynon & Dusu, 2010). It has also been associated with strengthened ownership and empowerment of recipient governments, increased donor alignment to recipient priorities, successful support to recipient PRS and improved PFM-systems (OECD DAC, 2006d; Development Information Services, 2006; Williamson, 2006; de Renzio, Andrews & Mills, 2010). In addition, General Budget Support has been associated with increased investment and growth in recipient countries (Lawson et al., 2006).

Despite the positive potential and experiences of General Budget Support, a number of possible problems, risk and challenges have also been associated with the method. The OECD-issued joint evaluation concluded that General Budget Support-inflows neither had led to increased empowerment of the poor nor to enhanced transparency and accountability in recipient countries. Neither did it live up to the increased predictability of aid-flows stipulated in the Rome Declaration (OECD DAC, 2006d). From a policymaker point of view, the list of challenges continue: Putting financial resources into the national treasury of a recipient country with weak financial management systems can raise the risk of disbursed funds being misused, as it is not possible to track the use of funds disbursed (Shand, 2006). It can also strain the capacity of the recipient government by overemphasizing donor development priorities (Koeberle & Stavreski, 2006). Donors can undermine the domestic accountability of a recipient government if the dialogue is donor-dominated. The role of recipients in formulating PRS has also been recognized as weak (Williamson, 2006; Alonso et al., 2006). The sought-after process of strengthening recipient financial systems has also been showed to be slow in some cases (National Audit Office, 2008). Conversely, donors have been shown not to disburse amounts they previously have committed to (Strategic Partnership with Africa, 2009).

The jointly agreed conditions – often in the form of institutional reform – are often breached

due to challenges in the recipient setting, often related to violent political opposition from domestic interests that oppose reforms. An agreement on long-term budget support can also be seen as "insurance" that allows recipients to perform poor without a cancellation of disbursements (Mosley & Abrar, 2006). Yet another problem is related to that recipient countries known for violating human rights still may display a "good" track record in areas that are used to assess the eligibility for budget support (Devarajan & Shah, 2006). Related to this line of thought is the problem is that donors who provide General Budget Support assume that recipient governments can be held accountable by its citizens – something that may not always be the case (Hauck et al., 2005). The role of General Budget Support in fostering democracy has also been questioned, as channelling funds to a government may not be the most appropriate mean to strengthening the parliament, the media and the civil society (Development Information Services, 2006).

Finally, it has been argued that the focus on the recipient and the "partnership-terminology" associated to General Budget Support is misleading, in that it implies that power differences in the development context are not longer present and that the preferences of donors and recipients align completely, which not actually may be the case (Booth, Christiansen & Renzio, 2006).

Evidently, the experiences and implications of the usage of General Budget Support are mixed. Although the method is recognized to have a number of advantages in the field of aid effectiveness, risks and challenges related to effects as well as selection of recipients are at hand.

2.2.3 Who is eligible for General Budget Support?

For the purpose of this thesis, the eligibility-aspect of General Budget Support can be seen as highly interesting yet somewhat puzzling. The recipient-focused, partnership-oriented approach to aid effectiveness combined with the method puts the recipient's own policies and institutions in focus. But is General Budget Support suitable for all recipients? Despite the well-established claim that General Budget Support is to be allocated to "good performers", there are no commonly accepted allocation criteria that decides who receives General Budget Support (Koeberle & Stavreski, 2006). This is due to the fact that there is no "universal approach" to the method is at hand among donors – different designs are adopted in different countries and vary among donors and recipients. This can be motivated by arguing that the usage of General Budget Support thus implies more than a yes or no-question, and involves

many choices related to size of disbursements, risks and results-monitoring (OECD DAC, 2006a, 2006e).

However, recipients typically share a set of characteristics, as Budget Support mainly is seen as suitable for “good performers” – recipient countries with “good policy environments” including strong ownership, commitment and capacity to allocate disbursed resources effectively (Koeberle & Stavreski, 2006; Gunning, 2006). This is to ensure the efficiency of General Budget Support, which depends on the recipients’ capacity of managing the funds disbursed (Development Information Services, 2006). When deciding to provide funds directly to the recipient’s national budget, donors thus need to balance the benefits of the method against the risks it may imply (OECD DAC, 2006a).

In order to be eligible for General Budget Support, the recipient government thus needs to display a will to commit to the General Budget Support-process, including an ability to engage with international partners and pursuing the own development-strategy. In addition, the recipient and the donor must reach a significant consensus on the development-strategy as well as a basic level of trust (OECD DAC, 2006e). Conversely, donors may not consider General Budget Support appropriate if the recipient government is seen as not having sufficient capacity to manage the funds disbursed (Development Information Services, 2006). The recipients of General Budget Support usually receive development aid in other forms as well, and all agencies that use budget support also use other aid modalities. There is thus often a complementarity between General Budget Support and other types of aid (OECD DAC, 2006e).

Despite the notion of disbursing Budget Support to “good performers” to ensure its effectiveness, the major OECD joint evaluation of General Budget Support concludes that donors apply different entry-conditions to different recipients. This pragmatic approach, with no fixed entry-criteria, is seen as fruitful as assessing the quality and commitments of recipients objectively may be very difficult. Furthermore, as General Budget Support can strengthen the quality of the recipients’ PFM-systems’ it may be justified to disburse it to “poor performers” as well (OECD DAC, 2006e). As will be evident in the following section, this rather positive view on the lack of fixed eligibility criteria can be seen as problematic in relation to previous research on aid and institutional quality.

2.3 Previous research

Whereas the previous section outlined the rationale of General Budget Support departing from a number of donor-issued publications, this section is concerned with previous research and empirical findings related to aid and institutional quality. As will be evident, the potential risks recognized by the donor community can be motivated by empirical findings as well.

2.3.1 The Effects of Aid – theoretical risks and rewards

There is a considerable body of publications seeking to depict the effects of aid. One can – broadly speaking – outline two strands of theoretical suggestions, where aid is associated with either positive or negative outcomes. These strands can be related to Wright and Winter's (2010) discussion of "aid optimists" and "aid pessimists".

On the one hand, it has been recognized that increased levels of aid is the best strategy to alleviate poverty in Africa, and that large, long-term aid-flows are required to achieve this. Following this line of thought, aid-inflows can be used to achieve a "big push" in public investments, which can increase the productivity in recipient states (Sachs et al., 2004). Aid-inflows can also be associated with increased growth, either through increased capital spending in recipient countries or by the fostering of growth-inducing policies (Wright & Winters, 2010). Furthermore, aid can be seen as a potential instrument for democratization through the strengthening of electoral processes, education systems, legislatures, a free press and civil society organizations in recipient countries (Knack, 2001; 2004). In addition, it has been recognized that aid-inflows may decrease corruption in recipient countries through conditions or through increased salaries for public employees (Tavares, 2003).

On the other hand, aid can be associated with undesired features such as corruption, declining democracy and inefficiency. Svensson (2006) associates aid with a geographical and political separation between taxpayers from a donor country and the beneficiaries in a recipient country. This separation can lead to shortcomings in accountability, where it is difficult to hold anyone accountable for the management of aid-resources. It has also been recognized that the beneficiaries of aid – the poorest people in the world – often lack the political power to influence aid bureaucracies (Easterly & Pfitze, 2008). Another basic problem related to aid has been illustrated by Boone (1996). Following his line of thought, the role of a government is to finance public goods. Conversely, the government can also make non-productive

transfers to the ruling elite. Theoretically, aid-inflows to a country can be used for both types of expenses, but the outcome depends on the preferences of the recipient government.

According to Bräutigam & Knack (2004), an aid-recipient government may actually prefer to remain non-productive, given that its revenue is secured through aid-inflows regardless how it performs. Aid may thus imply that there is no incentive for the recipient government to improve its capacity. Conversely, improved conditions in a recipient country could result in lower inflows of foreign aid (Bräutigam, 2000). Following this, aid can be seen as an “unearned income”, that ultimately grants recipient leaders access to funds without needing to rely on tax revenues (Wright & Winters 2010). Accordingly, recipient states with large aid-inflows do not need to collect revenue through domestic taxation. Thus, the exchange between taxation and the provision of effective policies and public services may not be established and the democratic accountability weakened. (Djankov et al., 2008; Goldsmith, 2001; Knack, 2001; Tavares, 2003). This negative aspect of aid can be embodied by the concept of moral hazard (Bräutigam, 2000; Goldsmith, 2001), which in turn can be seen as a fundamental political and organizational problem relating to the self-interest of public officials, where the inefficiency of public institutions allows them to gain personally (Miller & Falaschetti, 2001; Miller & Hammond, 1994).

According to Bräutigam and Knack (2004), aid may create incentives for recipient politicians and donor officials to maintain aid-flows regardless their effects. They also conclude that aid can undermine the access to capable staff in recipient countries, by attracting the most competent staff to donor-managed projects with salaries impossible to match by recipient governments. In addition, they conclude that when multiple donors pursue multiple donor-administrated projects in a country, the government of the country may be cut off from the management of aid resources, which in turn hinders it to develop its own capacity. Large inflows of aid can also result in “aid dependency” – a situation where a recipient government cannot perform its core functions and provide its citizens with basic public services without foreign aid (Bräutigam, 2000).

2.3.2 Institutions, aid and governance – theoretical implications

The notion of institutions is often found in publications related to aid. This thesis departs from a definition of institutions being “the rules of the game” and “the framework within which human interaction takes place” as provided by North (1990, p. 3-4). This is in line with the

definition provided by Bräutigam (2000, p. 23), who defines institutions as "sets of norms, codes of conduct, laws, and patterns of behaviour".

Following the discussion of North (1990), institutions can be formal or informal, whereas the former can be illustrated by formal rules, such as political and economic rules and contracts, and the latter by informal conventions. Created by human beings, shaped by legislators reflecting different interest groups and with an ability to evolve and change over time, institutions establish structures for human interaction and thereby contribute to determining the opportunities in a society. According to North (p. 33), an institutional framework consists of "legal rules, organizational forms, enforcement, and norms of behaviour".

According to North (1990), the institutional framework in a society in turn plays a major role for the economic performance by providing the structures for exchange and thereby determining costs of transaction. To what extent a society is able to develop effective enforcement of contracts is by North seen as a crucial factor for the economic performance. Effective judicial systems and well-specified bodies of law are examples of factors that enable contract enforcement. Thus they can be seen as "good" institutional features and thereby associated with the notion of high institutional quality. On the contrary, ambiguity of legal doctrines and uncertainty about agents' behaviour and insecure property rights are seen as negative for enforcement. These can in turn be seen as poor institutional features associated with low institutional quality. Following this line of argumentation, the quality of the institutional framework can be said to determine transaction costs, that in turn determine to what extent actors will engage in trade, that in turn foster wealth and development. Ideally, the institutional framework creates order and reduces uncertainty in exchange.

The quality of institutions has been showed to play a crucial role for per-capita income-levels and economic performance (Rodrik, Subramanian & Trebbi, 2004). Institutions may be measured different ways, but are often conceptualized in terms of growth fostering – for instance as protection against government expropriation, property rights and constraints on the incumbent (Acemoglu, Johnson & Robinson, 2001). Institutions are to be seen as somewhat context-specific, with origins in historical circumstances, geography, political economy and other initial conditions. Despite this, institutions in different contexts can embody the same economic and political core principles (Rodrik et al., 2004).

North (1990) associates “good” institutional aspects to “developed countries” and their opposite to “Third World countries” (p. 59). Poor institutional frameworks – that is, low institutional quality – in the latter, leads to higher transaction costs than in the former category. This is in line with the argumentation of Knack (2001), according to which institutional quality can be seen as a necessity for developing countries. Knack states that institutions that establish a predictable, impartial, and consistently enforced set of rules for investors are crucial for achieving economic growth – and thereby poverty reduction – in developing countries. According to Knack, such institutions can be encompassed by the concept “good governance”. The discussions provided by North and Knack thereby establish the relationship between institutions and development in a country, which is central for the purpose of this thesis. High institutional quality is thus associated with development, and vice versa.

Furthermore, not only does institutional quality play a role for the level of development in a country. Institutional characteristics as such are widely recognized as determinants of the impact of aid (Dollar & Levin, 2006) as well as the allocation of aid (Bräutigam, 2000).

The notion of institutional quality can in be seen as related to the concept of governance, which in turn has been recognized as difficult to define but can be associated with the impartiality of government institutions (Rothstein & Theorell, 2005). In relation to aid, Bräutigam (2000) associates governance with features such as increased transparency, greater domestic ownership of policies and programs, fiscal management and accountability. Problems related to governance include deficient official information, weak mechanisms of accountability, weakly enforced rule of law and ineffective bureaucracies (Bräutigam & Knack, 2004). According to Bräutigam and Knack, poor governance – including weak institutions and high levels of corruption – is a characteristic feature of many developing countries that receives aid. Aid can affect the institutional quality in recipient states, but the institutional quality in a recipient country also can affect how much aid a country gets, as outlined by Bräutigam (2000).

Institutions related to growth are often discussed in terms of transparency, openness to trade and property rights and rules and behaviours that implement them (Kaufmann, Kray & Mastruzzi, 2010). There are quantitative measures of institutional quality of countries in line with these aspects. For instance, a number of publications cited in this thesis (Alesina &

Weder 2002; Dollar & Levin 2006; Easterly & Pfutze 2008; Bräutigam & Knack 2006; Tavares 2003) depart from an index provided by the International Country Risk Guide (ICRG), that quantifies measures of Corruption, Bureaucratic Quality and Law and Order (Teorell et al., 2011). How institutional quality will be measured for the sake of this thesis is further outlined in the methods-section.

2.3.3 Aid and institutions – mixed empirical evidence

There is a considerable empirical body on previous cross-country research depicting the relationship between aid and recipient institutions. However, this research does not depict a unanimous tendency. The findings of Goldsmith (2001) suggest that aid-inflows do not undermine the quality of recipient institutions. Rather, his results indicate that aid-inflows are associated with higher levels of political and civil liberty in Africa. Dunning (2004) has showed a positive relationship between aid and levels of democracy in the post-Cold War era. Results presented by Tavares (2003) suggest that inflows of foreign aid may decrease corruption⁶⁴ in recipient countries.

Conversely, it has been shown that high levels of aid may erode the quality of recipient political institutions in terms of bureaucratic quality, corruption and the rule of law (Bräutigam & Knack, 2004; Knack, 2001) and democracy (Djankov et al., 2008). The findings of Bräutigam (2000) indicate that this negative association may be stronger in countries where aid comprises a large share of the Gross National Product (GNP). In addition, Boone (1996) provides evidence that aid inflows rather benefits ruling elites and increases the size of government than improve the conditions for the poorest in recipient countries. Furthermore, the findings of Knack (2004) indicate that aid-inflows do not promote democracy.

Aid-inflows have thus been recognized to be positively *and* negatively associated with the institutional quality of recipient countries by different researchers. It has been recognized that the somewhat contradicting results depicted above may depend on different approaches to data and methodology (Wright, 2009). The role of data in relation to the mixed results of aid-

⁶ The notion of "corruption" is in this thesis to be seen as "the extent to which public power is exercised for private gain" as put out in Kaufmann et al (2010, p. 4).

related research has also been discussed and demonstrated by Easterly, Levine and Roodman (2004). Furthermore, Alesina and Dollar (2000) underline that the negative findings can be discussed as a “hen or egg”-problem: Does a negative association between aid-inflows and institutional decline imply that aid is at the core of the problem or that aid is directed to assist recipients with their problems?

Several publications have indicated that the outcomes of aid depend on the institutional quality in recipient countries: According to Wright (2009), foreign aid can foster *or* hinder democratization depending on authoritarian incumbents’ perceived likelihood of getting access to aid funds after democratization. Ear (2007) concludes that aid has the potential to contribute to improvements *and* decreased quality of recipient institutions, as aid-inflows are shown to be associated with improvements in some governance indicators but decreases in others. This is in line with Rodrik (1996) who states that aid can help “bad” governments as well as “good” ones to survive and Easterly and Pfutze (2008) who conclude that bad governments make aid less effective.

Aid has been shown to have a positive impact on growth in settings where the recipient displays a “good policy environment” that fosters growth (Burnside & Dollar, 2000). The association between aid and growth has also been showed to depend on recipients’ level of democracy (Svensson, 1999). Stating that aid recipients operate in different institutional settings – that in turn fosters different behaviours – Wright and Winters (2010) conclude that there is no simple conclusion on the relationship between aid and economic growth. On the one hand, aid inflows could foster economic growth. On the other, it could provide cover for recipient governments to keep insufficient economic policies and political institutions.

The extent to which aid may contribute to corruption has been showed to depend on the existing institutions in recipient countries and the timeframes available to spend resources (Wright, 2008, 2010). Consistent with these findings, Wright and Winters (2010) conclude that the political institutions of an aid-recipient country determine how aid resources are spent. In turn, these institutions may or may not facilitate positive outcomes of aid. Bräutigam (2000) concludes that the effects of aid depend on the institutions in recipient countries. Following her argument, aid can be used well if the recipient has strong institutions and vice versa. The “problem” is thus not aid *per se* but rather poor institutions, which often are present in developing countries. Consistently, aid can be seen as a double-edged sword, which

can be used to improve as well as aggravate the institutions in recipient countries (Bräutigam & Knack, 2004).

2.3.4 The allocation of aid – the determining factors

Various researchers have recognized the potential problems of aid in relation to institutional quality and the fostering of unsound incentives. In order to overcome the potential risks of aid-inflows and decreasing quality of recipient institutions, it has been recognized that aid needs to be delivered in ways that promote “good governance” and removes the incentives for poor governance in recipient countries. This is also said to make aid-resources used more effectively (Bräutigam, 2000). To achieve this, it has been argued that “well-governed” countries with committed governments and sound policies should be offered increased levels of aid (Burnside & Dollar, 2000; Bräutigam & Knack, 2004; Collier & Dollar, 2002; Sachs et al., 2004). This is said to create incentives for good performance rather than its opposite. Bräutigam and Knack have also concluded that aid needs to be designed to support the recipient government instead of pursuing the donor’s agenda in order to make it more effective. This notion of allocating aid to recipients with “good” institutions has been labelled “institutional selectivity”, which means that aid is channelled to countries that “have the institutional and policy framework to use the resources effectively” (Dollar & Levin, 2006 p. 2036).

Which factors then determine how aid is allocated? Are donors practising the principle of allocating aid to “good” recipients as often stated? Theoretically, the answer to this may not be unanimously positive. It has previously been argued that aid-flows reflect the interests of donors rather than the needs of recipients (Boone 1996). Recipient needs can be seen as one of several factors that determine who receives aid (Wright & Winters, 2010). Maizels and Nissanke (1984) outline two broad and interlinked motivations for donors to disburse aid: to assist development in recipient countries and to promote their own interests. According to Schraeder et al (1998), aid may be allocated based on strategic interests of nation states, humanitarian needs in recipient countries or by the capitalist motives of ruling elites in recipient and donor countries. These three bases for allocation respond to the overarching paradigms of realism, idealism and neo-Marxism. Riddell (2007) outlines an aid-setting where the motives of poverty eradication, emergency-relief and the promotion of development, growth and human rights – often cited by official donors – are accompanied by a less outspoken pursuit of donor national, political and commercial interests and the fostering

of historical ties. Several other scholars have recognized this “hidden” dimension of aid: Svensson (2006) discusses foreign aid as a means of donors to influence policies and outcomes in another sovereign state. Alesina and Dollar (2000) conclude that aid allocation based on political and strategic interests of donors may “reward” corrupt and non-democratic recipients with “bad” policies and institutions, and thus reduce the likelihood for positive outcomes. Following their line of thought, aid allocation based on strategic interests may conflict with the often acclaimed general principles of foreign aid as a means to reduce poverty. Although often associated with industrialized and democratic donors (Schraeder et al 1998), it is important to underline is that aid is not to be seen as a solely “western” phenomenon. For instance, the Soviet Union and China have also used aid to pursue political objectives (Wright 2009; Wright & Winters 2010).

Several studies have confirmed the presence of donor interests in aid allocation. It has been showed that donors disbursed aid based on strategic and geopolitical considerations rather than on the level of democracy in the recipient countries during the Cold War (Dunning, 2004) even if Cold War-components may have diminished in present time (Wright & Winters, 2010).

Svensson (1999) has showed that while the disbursements from a few bilateral donors are associated with measures of democracy in recipient countries, donors in general do not allocate more aid to democratic countries. This may indicate that strategic and political motives – rather than the promotion of democracy – are prioritized by donors while providing aid. Results presented by Alesina and Weder (2002) indicate that donors in general do not discriminate corrupt governments from “good performers” when allocating aid. Their results also indicate that high levels of aid correlate with high levels of corruption in recipient countries. Donors have also been showed to allocate aid based on voting patterns in the United Nations General Assembly (Andersen, Hansen & Markussen, 2006) and on membership in the UN Security Council. (Dreher, Sturm & Vreeland, 2009; Kuziemko & Werker, 2006).

The findings of Alesina and Dollar (2000) indicate that strategic and political considerations of donors – rather than the policies and institutional quality of recipients – determine who receives foreign aid, although recipients who democratize may receive larger aid-inflows. They also show that bilateral donors allocate twice as much aid to a non-democratic former

colony than to a democratic non-colony. Accordingly, the allocation of aid based on colonial relations and voting patterns in the UN rather on institutional performance is seen as a hinder to achieve aid effectiveness. This is in line with the results presented by Collier and Dollar (2002), indicating that aid allocation is based on strategic and historical reasons and due to this often is directed to weak policy environments which in turn decreases the likelihood of poverty reduction. The findings of Neumayer (2003) indicate that far from all bilateral donors allocate more aid to recipients that respect human rights, although donors generally claim the opposite. Easterly and Pfutze (2008) conclude that although different donor agencies allocate aid based on different criteria, a lot of aid goes to corrupt countries and other countries than those that display the highest levels of poverty. This is in line with the findings of Schraeder et al (1998), who indicate that bilateral donors allocate aid based on strategic interest, economic self-interest and ideological similarities. They conclude that different donors allocate aid based on different considerations, and that the notion of foreign aid as an altruistic instrument as often claimed by donors needs to be rejected. The presence of donor interest can also be illustrated by Riddell's (2007) finding that the poorest countries receive less than half of total ODA-flows.

One way for donors to pursue their interests is to attach policy conditions to the aid they provide. According to Wright and Winters (2008) the goal of conditionality is to encourage recipient governments to undertake economic, political or institutional reform. White and Morrissey (1997) have stated that donor objectives for applying conditionality may depend on the context. Furthermore, they state that *ex post*-conditionality – meaning that previous performance of recipients are used to determine their eligibility – is more effective than *ex ante*-conditionality, which in turn is based on agreed future goals. The Monterrey Consensus and the Paris Declaration of Aid Effectiveness (PDAE) can be seen as ways of donors to frame conditionality in terms of donors “helping” recipients decide which reforms are most suitable (Wright & Winters 2010).

There may also be a difference between bilateral and multilateral donors when it comes to aid allocation: Burnside and Dollar (2000), conclude that multilateral donors do allocate more aid to countries with “good policies” but that this does not hold for bilateral donors. Charron (2011) has also showed that aid provided by multilateral donors is associated with lower level of corruption in recipient countries, whilst this does not hold for bilateral donors.

Theoretically, bilateral aid allocation may be based on colonial relations and geopolitical interest to a greater extent, while multilateral donors may be less affected by factors as such. Multilateral aid-flows have therefore been recognized to have a higher potential to reward “good performers” and penalize corruption (Alesina & Weder, 2002). The findings of Dollar and Levin (2006) indicate that multilateral aid is significantly associated with “good institutions” in recipient countries, embodied by democracy and rule of law. Due to this, multilateral aid is therefore labelled more “selective” than bilateral aid. The selectivity of donors is shown to have increased since the Cold War, mainly in terms of economic institutions. Dollar and Levin also show that bilateral donors tend to allocate aid to former colonies and countries in their own neighbourhoods. Multilateral donor-agencies have also been shown to be more sensitive towards the needs of recipients and less sensitive in terms of donor interest (Neumayer, 2003).

Following these results obtained by previous research, examining the determining factors for the allocation of General Budget Support can be seen as motivated.

2.3.5 Mixed implications of aid and institutions – a brief summary

As illustrated in this section, there are general issues related to aid. On the “output”-side, the effects of aid may be related to risks as well as benefits. Evidence presented in previous research is somewhat mixed. The effects of aid have been widely recognized to depend on the institutions in recipient countries. On the “input”-side, aid has been recognized to be more effective if allocated to recipients with “good” institutions. However, empirical evidence shows that donors do not only allocate aid based on the performance and needs of the recipients – their own interests may also influence the allocation.

The sources cited in this section outline what can be described as a clash where donors’ selectivity in favour of good performers can imply increased effectiveness, but also may contradict with their strategic interests, that in turn often has been described as determinants of aid allocation. Nevertheless, as outlined in the previous section, the rewarding of ‘good performers’ has gained increased attention from the donor-community over the past decade.

2.4 Outlining the research problem

As previous sections have outlined, there is a well-established debate of general issues related to aid and recipient institutions outlined by previous research as well as policy-documents and evaluations issued by main donor organizations. These two sources of publications commonly recognize benefits and risks associated to aid on an overarching level. Previous research typically departs from quantitative aid-variables based on the overarching concept of Official Development Assistance, whilst the World Bank and the OECD relies on qualitative approaches to a greater extent when examining the specific features of General Budget Support. This approach is intimately connected to the partnership-oriented agenda of aid effectiveness as outlined in the Paris Declaration on Aid Effectiveness, which puts recipients' priorities and systems in the centre of aid efforts.

The rationale of allocating General Budget Support to “good recipients” is well in line with the previously cited research that states that the impact of aid depends on the quality of recipient institutions (Burnside & Dollar, 2000; Svensson, 1999; Wright 2008; Wright, 2010; Wright & Winters, 2010; Bräutigam, 2000). In the context of General Budget Support, this line of thought can be extended to also include the *input* of aid: General Budget Support is seen as suitable for recipient countries with sufficient institutional quality (Koeberle & Stavreski, 2006).

Yet, the experiences of General Budget Support are mixed, and most evaluations depart from single cases. Institutional quality should determine allocation, but no fixed eligibility criteria are at hand. Despite the risks of corruption and misuse of aid resources, donors hold that it may be justified to allocate General Budget Support to recipients with weak institutional quality as well, as this may improve their institutions (OECD DAC, 2006e). Given this somewhat contradicting allocation aspect, how do donors allocate General Budget Support in practice?

Central to the problem formulation of this thesis is what may be referred to as a “double nature” of General Budget Support: It is labelled un-earmarked and connected to the concept of partnership *but* in practice donors decide about disbursements and influence the recipients' policies. It can strengthen the recipients' institutions *but* can at the same time weaken domestic accountability if allocated to “poor performers” with weak institutional quality, which may imply risks in the form of corruption. It is seen as more suitable for “good performers” with sufficient capacity to live up to agreed strategies and thus ensure aid

effectiveness *but* can also improve conditions in “bad” recipient countries. Furthermore, no fixed eligibility criteria exist, which can qualify “poor performers”, *but* recipients with weak institutions may increase the risk for the misuse of funds provided.

Given its absence in previous research and its focus on the recipients, combined with the potential risks of aid-inflows distorting domestic accountability and fostering incentives for corruption in recipient countries, General Budget Support can be seen as highly interesting in relation to previous aid-related research.

Who receive General Budget Support? Does the institutional quality of recipients’ of General Budget Support determine the allocation of funds as donors’ claim that it should? As the existing evaluations of the method to a large extent are based on single cases, an overarching cross-country tendency is hard to outline. Does the quality of recipient institutions determine the allocation despite the lack of fixed eligibility criteria? A considerable body of previous research presented in previous research (Alesina and Weder 2002; Boone 1996; Maizels & Nissanke, 1984; Schraeder et al, 1998; Riddell 2007; Svensson, 1999; Svensson, 2006; Dunning, 2004; Andersen et al, 2006; Dreher et al, 2006) indicates that donors may not only allocate aid based on the performance and needs of recipients, but also may let allocation be influenced by their own interests. However, the conclusions of this research are almost in every case based on aid measured as ODA. Few (if any) quantitative cross-country approaches seem to depart from aid measured as General Budget Support, with the work of Beynon and Dusu (2010), presented in an “informal discussion paper” issued by the European Commission, as one rare exception.

By departing from General Budget Support, this thesis may therefore contribute to an extended knowledge of aid allocation, relevant for previous research as well as for the policy-based debate on aid effectiveness. Is the tendency of aid allocation based on donor interest still to be found when the concept of aid is “narrowed” from ODA to General Budget Support? Or is General Budget Support, as has been claimed, first and foremost allocated to recipient countries with good institutions, as suggested by central donor-agencies? Or simply put: To what extent are disbursements of General Budget Support associated with the institutional quality of recipient countries? The aim of this thesis is to further investigate this.

This formulation of research problem is based upon two core recognitions. First, a main part of previous cross-country research on development aid is based on the broad definition of development aid as ODA. Secondly, previous donor-issued evaluations of General Budget

Support are based on single country-experiences and rather focus on the “output”-side of the method than on the “input”-side. This thesis seeks to bridge these two gaps, by focusing solely on the “input”-side of General Budget Support in a quantitative cross-country study. The approach of this thesis can therefore be seen as relevant in relation to previous research as well as to the recent policy-debate on aid effectiveness.

2.4.1 Purpose and research question

The general purpose of this thesis is to investigate to what extent donors allocate General Budget Support to recipient countries with high institutional quality. This formulation of purpose departs from a theoretical foundation derived from previous research, suggesting that donors may not allocate aid primarily based on recipient needs and performance, whilst the institutional quality of recipient countries is associated with the outcomes of aid.

The answering of the following research question will fulfil this purpose:

Does the institutional quality of recipient countries determine the allocation of General Budget Support?

3. Research design, method and variables

3.1 Research Design

As the research question of this thesis seeks to investigate the association between General Budget Support and institutional quality among different recipient countries, a cross-sectional design will be adopted. This design is associated with the investigation of multiple research-units at a single point in time with quantitative data (Bryman, 2008). The research question will be answered through statistical analyses of numbered variables. This approach responds the notion of quantitative research design as defined by Creswell (2009) and is predominantly adopted in the research cited in the theory-section of this thesis.

According to Bryman (2008) quantitative research may be associated with a deductive relationship between theory and research and the notion of a measurable objective reality. This can be contrasted to qualitative research, which in turn may be associated with the generation of theories and the notion of a constructed reality that can be interpreted in different ways. Following the line of thought presented by Creswell (2009), a quantitative design can, at a glance, be contrasted to a qualitative ditto. Whereas the former can be associated with statistical analysis and numerical measures, the latter can be associated with interpretations on how individuals and groups understand problems and concepts. According to Creswell, these two approaches are not to be seen as absolute opposites but rather as complementary. This notion is acknowledged throughout this thesis. Deriving from it, the approach of a case study – by Creswell mainly associated with qualitative research – will influence this thesis. According to Creswell, a case study implies that the research is focused on one or several specific entities. By selecting one donor – that thus will represent the “case” in this thesis – the allocation of General Budget Support can be compared to legislation to a greater extent that would have been possible if several donors with different allocation policies had been chosen. Given that different providers of General Budget Support – bilateral and multilateral – may depart from different policies and legislations, a study examining the allocation of General Budget Support from *all* donors to *all* recipients would have been hard to conduct. The design of this thesis is a comparative study of recipient countries that have signed the Cotonou agreement with the European Union (EU).

3.2 Selection of Case: The European Commission

This thesis departs from the European Union, and its executive body the European Commission (henceforth the Commission), as provider of General Budget Support. Starting to disburse aid in the form of Budget Support in 2001, it was one of the first donor agencies that implemented the approach (Hauck, Hasse & Koppensteiner, 2005). The Commission is responsible for proposing and enforcing legislation in the Union's member states, implementing EU-policies and allocate EU-funds (European Commission, 2012a). General Budget Support allocated by the Commission is thus funded by the EU Member States.

The Commission provides greater volumes of ODA than main multilateral organizations such as the World Bank and the United Nations Development Programme (OECD DAC, 2007). In 2009, the total ODA provided by the EU and its Member States amounted to €49 billion (European Commission, 2010a). The often stated claim that the EU and its member states together comprise “world's largest donor” (European Commission, 2012b) can further motivate why its executive body can be seen as a critical and relevant case for this thesis. Theoretically, aid provided by the European Commission could be seen as representative for the donor community given that the Commission – just like other main donors (bilateral as well as multilateral) – are members of the OECD DAC and adhere to the principles of the Paris Declaration of Aid Effectiveness that emphasizes the need for allocating aid through recipient systems in order to enhance aid effectiveness. It is therefore likely that the Commission's policies on aid allocation and General Budget Support are similar to other donor organisations ditto. It is therefore plausible that the results obtained by this thesis may be applicable to other donors as well.

The selection of the Commission can also be motivated by the focus on recipient priorities found in central development-policy documents of the EU. The European Consensus on Development (ECD), jointly agreed by representatives of the governments of the Member States and the main EU organizational bodies⁷ in 2005, sets out poverty eradication through sustainable development and the achieving of the MDGs as the key objective of the EU development policy. In the ECD, poverty is defined as a multi-dimensional concept which core comprises of the deprivation of economic, human, political and protective capabilities of humans. The notion of development is also related to good governance, human rights and

⁷ The Council of Ministers, the European Commission and the European Parliament.

various political, economic, social and environmental aspects. It is also stated that the development-efforts – in the form of partnerships and dialogue – carried out by the EU and its member states will ”promote respect for human rights, fundamental freedoms, peace, democracy, good governance, gender equality, the rule of law, solidarity and justice”. According to the ECD, EU-aid is to be allocated based on “standard, objective and transparent” criteria. These criteria should address the needs as well as performance of recipients (Official Journal of the European Union, 2006, paragraphs 1, 5, 7, 13-15, 23, 25-26, 64-66). The ECD is thus heavily influenced by the core principles of the Paris Declaration, as the ownership of “partner countries” is stressed as important and the responsibility for development efforts is to be seen as mutual. Furthermore, it states that aid efforts are to be increased and improved through boosted aid-flows and reduced transaction costs. The Commission has also recognized the importance roles governance and recipient institutions for successful aid-effects to be achieved, and states that this recognition is at the core of EU development strategies (European Commission, 2012e).

Recognizing the potential failure of reaching all Millennium Development Goals, the Commission has recently underlined that EU-development efforts need to be up-scaled, recognizing that the jointly agreed target on allocating 0,7 % of total Gross National Income (GNI) to ODA by 2015 may not be achieved (European Commission, 2010a). Regardless the call for increased aid-flows, these alone are not seen as sufficient to achieve the MDGs. Aligning with the publications cited in the theoretical section of this thesis, the Commission therefore stresses the importance of recipients’ institutions as it states that the use of recipient strategies and systems – in particular PFM-systems – through Budget Support is seen as an overarching principle of these increased development efforts, as it may increase the ownership and state legitimacy of the recipients.

Following this, the European Commission can be seen as a relevant and up-to-date “vessel” of the policy-principles of aid effectiveness and allocation based on “good“ recipient institutions outlined in the previous parts of the thesis.

3.2.1 General Budget Support provided by the European Commission

Departing from the Paris Declaration, the ECD (paragraph 26) states that the use of General Budget Support should increase "where circumstances permit" in order to increase aid effectiveness.⁸ Over the period of 2003-2009, Budget Support (Sector and General) commitments comprised over 13 billion Euros or about 25 % of all aid commitments made by the Commission. Budget Support-commitments as a share of total aid commitments were during this period highest in the ACP-countries⁹ with a total of 56 % (European Commission, 2012f). In the context of the Commission, Budget Support is not solely referring to the transfer of financial resources. Rather, it should be seen as a "package including policy dialogue, performance assessment, capacity-building and other supporting interventions" (European Commission, 2010b, p. 6).

The Commission's view on General Budget Support mainly responds to the positive connotations as outlined in the previous section. Benefits for recipients as well as donors are recognized: The accountability of the recipient's national parliament is expected to strengthen when its ability to carry out essential functions related to welfare provision to its citizens increases. Furthermore, the use of Budget Support is by the Commission seen as a way to alleviate poverty through reducing the number of donor-driven projects (harmonisation), emphasizing the priorities of the recipient (alignment) and strengthen its PFM-systems (capacity building) (European Commission, 2008a). On the donor-side, Budget Support is seen as the "best instrument for encouraging our partner countries to implement their strategies to reduce poverty" (ibid., p. 18) It is also seen as way for donors to "promote good governance by supporting the partner country's institutions" (ibid.). This choice of vocabulary corresponds to North's (1990) definition of institutions as well as the theoretical foundation suggesting that aid can improve the institutional quality in recipient countries.

Does then the Commission allocate General Budget Support to recipients with high institutional quality? As the Commission took part of the OECD DAC joint evaluation of General Budget Support cited in the previous section, it is aware of the potential risks

⁸ Important to underline is that the ECD also outlines several other aid modalities, including project aid and humanitarian assistance. As these modalities are outside the scope of this thesis, they will not be further discussed in relation to the European Commission.

⁹ ACP-countries refers to African, Caribbean and Pacific countries.

associated to the method (European Commission, 2007). The allocation of General Budget Support is mainly discussed in terms of economic measures and performance of the recipients (European Commission, 2008a, p. 33): A recipient's PFM-system needs to be "sufficiently transparent, reliable and effective" and its macroeconomic policies need to be "positively assessed". The Commission (2008a) has outlined three distinct eligibility criteria for Budget Support, namely "a well-defined national or sectoral policy and strategy; a stability-oriented macroeconomic policy; and a credible and relevant programme to improve public finance management" (ibid. p. 40). The Commission (2012f) is keen to underline that Budget Support *only* is disbursed to recipients that meet three eligibility criteria. When the criteria are not met, Budget Support is not to be disbursed. However, the Commission also openly states that it has no minimum criteria for disbursements. If the policy of the recipient is "relevant" and "credible", Budget Support is seen as a suitable method (ibid., p. 49-50). For the purpose of this thesis, this claim is highly interesting. In addition to the criteria for General Budget Support, the Commission also stresses the need for democracy, human rights and governance in recipient countries if EU aid is to be allocated (2008a).

Despite the claim that the General Budget Support only is provided to countries that meet the criteria (European Commission, 2012f), the Commission has been criticized for its way of disbursing GBS. The external investigatory audit agency of the EU – the European Court of Auditors (2011) – has also criticized the Commission not managing the risks associated with the method appropriately and for not even having a sufficient method to do this. This is associated with shortcomings in eligibility-assessments, where the Commission is criticized for using a dynamic interpretation of the eligibility criteria. The Court of Auditors has therefore concluded that weak institutional performance, in the form of PFM-systems and development-oriented policies, may not hinder the Commission from disbursing General Budget Support. This is illustrated by the claim that General Budget Support – despite the eligibility criteria – sometimes is allocated to recipients with weak PFM and corruption. In addition, the Commission has been criticized for not displaying clear explanations on how allocations of General Budget Support are made and for not adjusting the General Budget Support programmes to the specific circumstances of the each recipient country.

The use of General Budget Support in the context of the Commission may therefore not be seen as unproblematic. The dynamic interpretation of eligibility criteria recognized by the

Court of Auditors and the absence of democracy-related aspects in the three main eligibility criteria further motivates why it is a relevant point of departure for this thesis.

3.2.2 Selection of recipients: the Cotonou agreement

The development-efforts of the EU as carried out by the European Commission ranges to a wide list of recipient countries all over the world (European Commission, 2012j). However, the ECD emphasizes that increased aid-efforts especially are required in Africa in order to achieve the MDGs (Official Journal of the European Union, 2006). Several of the sources cited in the theory-section of this thesis also explicitly depart from African countries (e.g. Bräutigam & Knack, 2004; Dunning, 2004; Goldsmith 2001; Schrader et al, 2008). Other previously cited publications typically also include African countries even when the recipient-list is more extensive (e.g. Djankov et al, 2008; Dollar & Levin, 2006; Knack 2004). Given the presence of the continent in previous research and the policy-documents of the Commission, the data upon which this builds will depart from an Africa-sample. The data will also include a number of Pacific and Caribbean states – namely, the signatories covered by the Cotonou Agreement.

The Cotonou agreement is the framework for the EU's relations with 78 countries from Africa, the Caribbean and the Pacific (henceforth ACP-countries).¹⁰ This agreement – by the Commission labelled “the most comprehensive partnership agreement between developing countries and the EU” – has the main objective is to reduce and ultimately eliminate poverty (European Commission, 2012i). This objective is to be achieved through development-cooperation, economic and trade cooperation and political dialogue. The Cotonou agreement was signed in 2000 and entered into force in 2003, but builds on a long tradition of relations between the EU and the ACP-countries. A tradition that – according to the Commission – is based on partnership, mutual interests and interdependence (European Commission, 2012d). The Cotonou agreement thus builds on the previous contractual agreements between the EU and the ACP countries of the 20th century (the Lomé conventions), which have emphasized aid, trade and political aspects in the cooperation between the parties.

Article 61.2 of the Cotonou agreement (Official Journal of the European Union, 2000) outlines the provision of Budget Support to ACP-countries. It is stated that it shall be granted where “(a) public expenditure management is sufficiently transparent, accountable and

¹⁰ See Appendix A for a complete list of countries covered.

effective; (b) well defined macroeconomic or sectoral policies established by the country itself and agreed to by its main donors are in place; and (c) public procurement is open and transparent.” These formulations were valid during the year of disbursement of focus for this thesis – 2008.

The Cotonou agreement, along with the ECD, thus provides a common policy for the Commission's allocation of Budget Support to the signatories among the ACP-countries. It is therefore a relevant point of departure when selecting recipients to examine. Given the its outspoken ambition to allocate General Budget Support to “good” recipients, if an association between allocation and institutional quality is not found in the case of the Commission, it may not be found elsewhere either.

3.3 Method

A quantitative method has been chosen to address the research question, mainly by conducting Ordinary Least Squares (OLS) regressions. OLS implies that numbered variables are fitted into a linear model, where the sum of squared residuals (the difference between actual and predicted values) is as low as possible. For the sake of this thesis, a variable is defined as “a characteristic or attribute of an individual or an organization that can be measured or observed” (Creswell 2009, p 50). OLS thus estimates parameters of linear models, where it is possible to examine the association between independent x-variables and dependent y-variables (Hamilton, 1992) and the extent to which the x-variables determine the y-variable. The association between the variables will also be examined through correlation analyses. The correlation indicates the relationship between two variables and theoretically stretches from -1 to +1.

For the purpose of this thesis, a dependent variable based on allocation of General Budget Support will be constructed and examined in relation to a numbers of independent variables measuring institutional quality in recipient countries.¹¹ As a first step, bivariate correlation analyses will compare the variables two at a time. This can shed light on the extent to which the dependent and independent variables correlate (Hamilton, 1992). The bivariate analysis will be followed by bivariate and multivariate regression analyses, the latter with all independent variables and control variables included. This will allow for conclusions to be drawn on the extent to which institutional quality determines the allocation of General Budget

¹¹ The variables are further described in Appendix B.

Support. Following the line of thought presented by Hamilton, the insertion of the control variables may allow a check for spuriousness, the extent to which possible relationships between the independent and dependent variables is a result from their relation with other variables.

The use of OLS regressions is intended to investigate the extent to which institutional quality determines the allocation of General Budget Support. Important to underline is that the causal relationships between the variables can be further discussed. Bearing the “hen or egg”-discussion provided by Alesina and Dollar (2000) in mind, the difficulties of addressing causality in relation to aid and institutions are acknowledged. Perhaps needless to say, it is not likely that an absolute causality between General Budget Support allocation and institutional quality exists. Factors such as budgetary restrictions of donors would not allow for unlimited allocation, no matter how high institutional quality a recipient display.

The results from the regressions will be used to answer the research question. A positive significant relationship between GBS-allocation and institutional quality may indicate that “good” recipients *are* favoured, whereas the opposite (or a lack of correlation) could imply a negative answer to the research question.

The choice of OLS regressions as method can not least be seen motivated as it is widely used in the previous research on aid and institutions as previously cited¹² (Acemoglu et al, 2001; Bräutigam & Knack, 2004; Burnside & Dollar, 2000; Bräutigam, 2000; Collier & Dollar, 2002; Djankov et al 2008; Dreher et al, 2009; Ear, 2007; Easterly et al 2004; Knack, 2001; Rajan & Subramanian, 2007; Sachs et al, 2004; Wright, 2007; Svensson 1999). The method is therefore seen as relevant for the purpose of this thesis.

3.3.1 The dependent variable: General Budget Support

Previous research concerned with aid and institutional quality cited in this thesis departs from similar, yet sometimes different measures of the concepts of interest for this thesis. As stated in the theory-section, aid is predominantly measured as ODA. The previous research on aid and institutions cited in this thesis nevertheless departs from aid-variables that may vary slightly. Some use ODA as a share of Gross Domestic Products (GDP) in recipient countries

¹² Some of these authors use other types of regressions in combination with OLS.

(e.g. Collier & Dollar, 2002; Djankov et al, 2008; Svensson 1999), others ODA as a share of Gross National Products (GNP) (e.g. Boone, 1996; Bräutigam, 2000; Dunning, 2004; Goldsmith, 2001; Knack, 2004) and yet others depart from ODA as a share of Gross National Income (GNI) (e.g. Wright, 2007). Aid-variables have also been constructed on a “donor-basis”, where ODA from different donors are compared (e.g. Alesina & Dollar, 2000) In addition, some publications depart from other aid-data than ODA-measures (e.g. Burnside and Dollar, 2000; Easterly et al 2004; Neumayer, 2003). The various “aid-variables” have in turn been used as either dependent or independent in different publications.

Inspired by the approach of Alesina and Weder (2002), this thesis will use its aid variable – allocation of General Budget Support – as the dependent variable. This variable will be based on data on the Commission's commitments of General Budget Support extracted from the OECD Creditor Reporting System (CRS) Aid Activities database.¹³ This database builds on official data reported to the OECD DAC by its members, and divides aid flows into the two sub-categories *allocated* and *disbursed*. The data is processed and controlled by the OECD DAC secretariat (OECD DAC, 2012e). The choice to depart from commitments of General Budget Support rather than disbursements can be motivated by Anderson et al (2006). According to them, commitments are fully controlled by the donor, whereas disbursements partly rely on recipient behaviour. The use of commitments thus reflects the initial intention of the donor to a greater extent than would have been the case if disbursements would have been used. The variable is coded so that low inflows of General Budget Support correspond to a low value, and vice versa.¹⁴

Figures on General Budget Support will be based on commitments made for the year 2008. This is motivated by two factors: It is *after* the adoption of the Paris Declaration on Aid Effectiveness and the European Consensus on Development, and allocations was highest this year compared to other years of the past decade with available data. The year of focus thus corresponds to a policy-environment heavily influenced by the focus on the recipient in order to enhance aid effectiveness.

3.3.2 Independent variables

The notion of institutional quality has been conceptualized and measured in different ways in

¹³ Available online at <http://stats.oecd.org/Index.aspx?DatasetCode=CRSNEW> (2012-04-29).

¹⁴ See Appendix B.

previous research. According to Bryman (2008), the use of multiple indicators of a concept can make a study more accurate. The overarching notion of institutional quality can thus be illustrated by different indicators. Therefore, three indicators of institutional quality will be used as independent variables for the sake of this thesis. These measures are all possible to relate to the discussion on institutions provided by North (1990).

Sources cited in this thesis depart from different datasets and variables addressing institutional quality and governance. A number of publications depart from data which focuses on bureaucratic quality, rule of law, and corruption provided by a commercial service called the International Country Risk Guide (ICRG) (Alesina & Weder 2002; Bräutigam, 2000; Bräutigam & Knack 2004; Charron, 2009; Dollar & Levin, 2006; Knack, 2001; Tavares 2003). Bräutigam and Knack has identified the ICRG data as particularly suitable in relation to aid-related research. However, the commercial nature of this dataset, as well as the lack of coverage of the ICRG-variable in the freely available QoG-dataset, contributed to the decision to not depart from the ICRG-data in this thesis.¹⁵

Rather, this thesis will depart from the World Bank's World Governance Indicators (WGI) when it comes to independent variables. The WGI are based on perceptions and consist of six aggregate measures that address voice and accountability, political stability and absence of violence or terrorism, government effectiveness, regulatory quality, rule of law, and control of corruption (Kauffmann et al, 2010). These six dimensions of governance have been recognized as relevant in relation to aid (Ear, 2007). The WGI are used in publications by Rodrik and Trebbi (2001), Sachs (2004) and Ear and can thus be seen as relevant in relation to previous research in the field of aid and institutions.

In line with the eligibility criteria for General Budget Support outlined in the Cotonou agreement, the discussion on institutions provided by North (1990) and the previous research outlined in the previous section, the WGI measures "Rule of Law" and "Control of Corruption" will be deployed. The Quality of Government dataset provided by Teorell et al (2011) will serve as the source for the WGI-measures.

¹⁵ More info to be found at https://www.prsgroup.com/prsgroup_shoppingcart/pc-66-3-countrydata.aspx (2012-04-29).

Important to underline is that the six dimensions of governance of which the WGI consists are not to be seen as independent of each other. As stated by Kauffmann et al (2010), it is likely that the dimensions are positively correlated across countries and that it may not be possible to divide the overarching notion of governance into clear-cut individual measures.

In addition, an independent variable addressing the level of democracy in recipient countries will be included. This variable is based on the democracy index of Freedom House and is consistent with the approaches of Alesina and Dollar, (2000) Dollar and Levin (2006), Goldsmith (2001), Neumayer (2003) Svensson (1999). The democracy-variable is also extracted from the Quality of Government-dataset (Teorell et al., 2011).

The three independent variables used address rule of law, corruption and level of democracy. Following the discussion of Dollar and Levin (2006), the WGI-variables can be seen as addressing economic institutions whereas the Freedom House-variable can be associated with political institutions. The independent variables used will be lagged, meaning that they will be covering years before 2008. This will allow for an analysis that addresses the extent to which the institutional quality at a previous point in time actually determines the allocation of General Budget Support.¹⁶

3.3.3 Control Variables

A control variable is a variable that may influence the relationship between the dependent and independent variables (Sundell, 2012). The inclusion of control variables in a regression analysis thus allows for more justified conclusions to be drawn. For the purpose of this thesis, the control variables are based on possible other determinants of aid allocation as recognized by previous research.

Following the argumentation of Boone (1996), the population of recipient countries will be used as a control variable. According to his argument, countries with smaller populations may have relatively more influence “for sale” than more populous countries. Following this rationale, countries with smaller populations are likely to receive relatively larger amounts of aid. This argument is supported by the findings by Alesina and Dollar (2000), who conclude that small countries get more aid per capita. A variable measuring population, taken from the

¹⁶ Further information on the variables is found in Annex B.

QoG-dataset, potentially addressing the notion of donor strategic interest, will therefore be included consistent with the approaches by Boone and Alesina and Dollar.

In addition, a control variable addressing poverty will be included. According to Boone (1996), infant mortality is one of the best indicators of poverty. Countries with high infant mortality are in more need of foreign aid (Neumayer, 2003). According to Ear (2007), infant mortality can be seen as a basis for aid allocation regardless of the institutional quality in recipient states. Infant mortality will therefore be used as control variable. The variable will be lagged, in line with the approach adopted by Knack (2001).

Following the argumentation of Ear (2007) these two control variables can be said to address recipient needs as well as donor interest in relation to the allocation of General Budget Support. The use of them can also be motivated by Knack (2001) who states that population and infant mortality, along with per capita income, can be seen as the most significant predictors of aid. The two control variables will also be taken from the Quality of Government dataset (Teorell et al, 2011).

3.3.4 Discussion on shortcomings, analytical power and generalizability

The main motivation for the quantitative approach chosen for the purpose of this thesis is its presence in previous research on aid and institutional quality, combined with the lack of quantitative research that addresses General Budget Support specifically. The quantitative approach of this thesis can also be contrasted to many of the donor issued publications on General Budget Support, which predominantly departs from qualitative approaches, and thereby be seen as a complement to their conclusions. Thus, this thesis can hopefully bridge the gap between previous quantitative research concerned with ODA (but not General Budget Support) and donor-issued evaluations concerned with qualitative evaluations of General Budget Support.

Nevertheless, it is recognized that a qualitative approach also could have been adopted for the purpose of this thesis. A plausible alternative qualitative design and method could have been to compare one recipient country with very high inflows of General Budget Support to a recipient country with very low inflows and investigate to what extent the difference in allocation could be associated with the initial institutional quality of the two recipients. Interviews and text analyses, rather than regressions, could have been used for this approach. However, this approach would have made it hard to compare the results to previous findings

based on quantitative studies. On the other hand, following the discussion outlined by Bryman (2008), a qualitative approach could have shed light on how various actors in the aid-context interpret institutional aspects related to General Budget Support.

Quantitative research as carried out by social scientists can be criticized on a number of grounds. Following Bryman's (2008) discussion, it may be accused of treating data as static and constant rather than constructed and interpreted, even if the latter description may be more accurate. Furthermore, quantitative research can be seen as overly optimistic when it comes to the belief in measures and their accuracy. From a “qualitative point of view”, the concepts and measures adopted in quantitative research may be thus seen as constructed rather than definite. Taking into account this potential criticism, the approach of this thesis can be seen as imperfect yet sufficient and relevant in relation to previous research and to its purpose. The data and variables used in this thesis are not chosen because they are the *only* existing measures of the concepts of interest, but because they are well established in the context of previous research as well as in the relevant policy setting.

According to Hamilton (1992) OLS regressions can be said to have many advantages when certain conditions are fulfilled and be seen as the best linear unbiased estimator. For this to hold, a number of conditions need to be fulfilled. For instance, measurement errors have to have constant variance and have to be uncorrelated with each other. Ideally, neither the independent x-variables nor the standard errors should be correlated with each other. However, ultimate conditions for OLS as such are rarely found in practice. Important to underline is also the concept of omitted variables – variables that may affect the dependent as well as the independent variables and thereby make true estimations about the relationships misleading. Recognizing these risks, diagnostic tools and re-coding are used in order to overcome potential risks as such.¹⁷

Following the discussion of Bryman (2008), departing from well-known and established sources can ensure high quality of data. Furthermore, it can make this study repeatable and thereby implies high *reliability*. The operationalization of institutional measures in this thesis corresponds to previous research, which can be seen to imply what may be referred to as *validity*. It is acknowledged that the usage of official sources – such as the OECD – does not

¹⁷ See Appendix B.

guarantee that the data is perfect. As Bryman (2008) has stated, all datasets may suffer from problems related to lack of data and shortcomings in collection procedures. For the sake of this thesis, it is therefore acknowledged that all social measurement is prone to errors that in turn can be minimized. In order to do so, the OLS guidelines by Hamilton (1992) have been adopted.

Important to underline is finally that the operationalization of institutional quality also could have been made differently. Following the discussion provided by (Creswell 2009), the extent to which the independent variables affect the dependent can be related to the question of *internal* validity. Given that omitted variables also may influence the outcome, this cannot be absolutely guaranteed. The usage of well-established control variables can hopefully serve as a means to ensure a sufficient degree of internal validity. As of *external* validity – or the extent to which the findings of this study may be generalized – the Commission adhere to the same principles of the Paris Declaration as many other major donors. This could make the results of this study relevant in relation to other donors who disburse Budget Support and adhere to the same overarching policy principles of aid effectiveness and ownership, and thereby contribute to the analytical power of the thesis.

4. Results and analysis

Are there then any significant relationships between institutional quality and the allocation of General Budget Support? A correlation analysis does not display any significant relationships between the variables.¹⁸ The lack of significant correlation between institutional quality and the allocation of General Budget Support is further illustrated by the subsequent scatter plots.

Table 1. Correlations between variables

Variable	GBS as share of GDP	Control of Corruption	Rule of Law	Democracy	Population (ln)	Infant Mortality
GBS as share of GDP		-0,123	-0,179	-0,101	0,271*	0,452**
Control of Corruption	-0,123		0,842**	0,603**	-0,513**	-0,657**
Rule of Law	-0,179	0,842**		0,718**	-0,593**	-0,720**
Democracy	-0,101	0,603**	0,718**		-0,556**	-0,645**
Population (ln)	0,271*	-0,513**	-0,593**	-0,556**		0,719**
Infant Mortality	0,452**	-0,657**	-0,720**	-0,645**	0,719**	1

*** = $p < 0.001$ ** = $p < 0.01$ * $p < 0.05$

¹⁸ A discussion on multicollinearity is found in Appendix B.

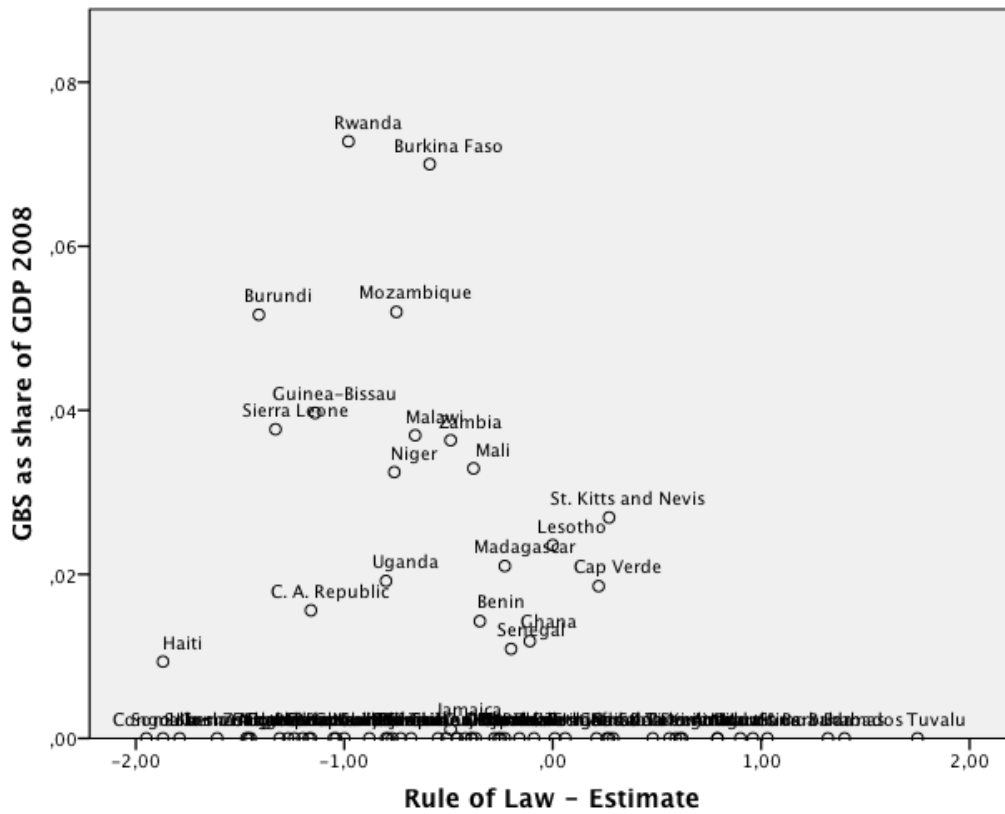


Figure 3. Scatter plot illustrating the relationship between the allocation of General Budget Support and Rule of Law.

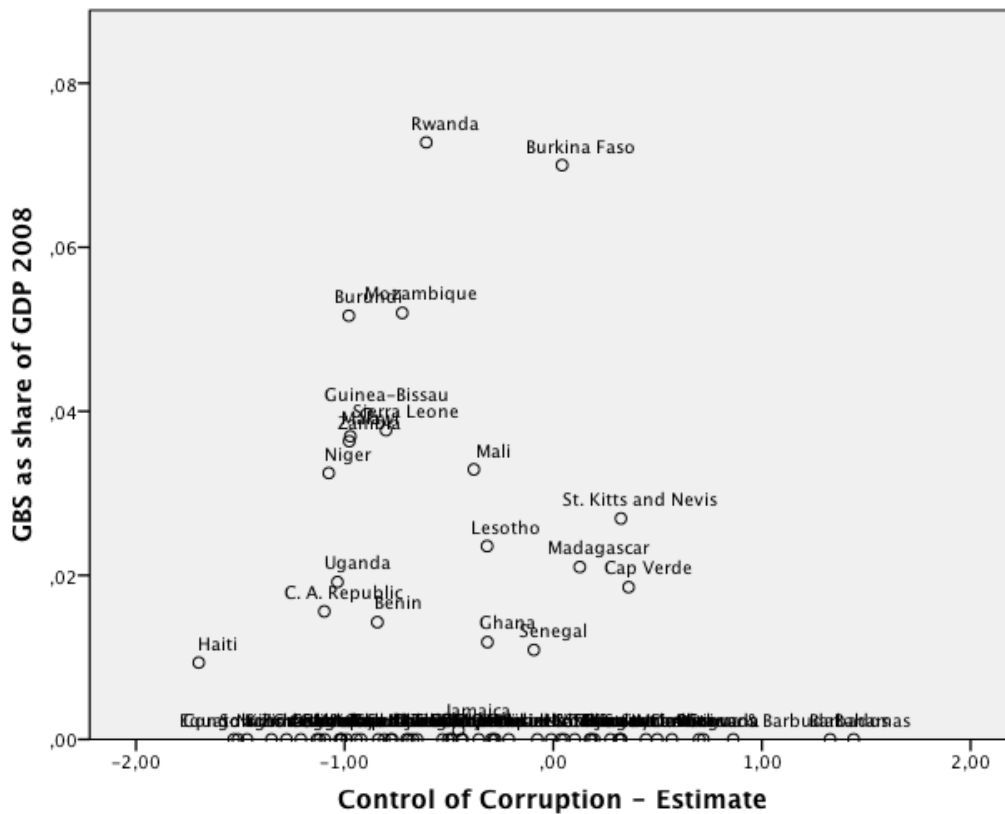


Figure 4. Scatter plot illustrating the relationship between the allocation of General Budget Support and Control of Corruption.

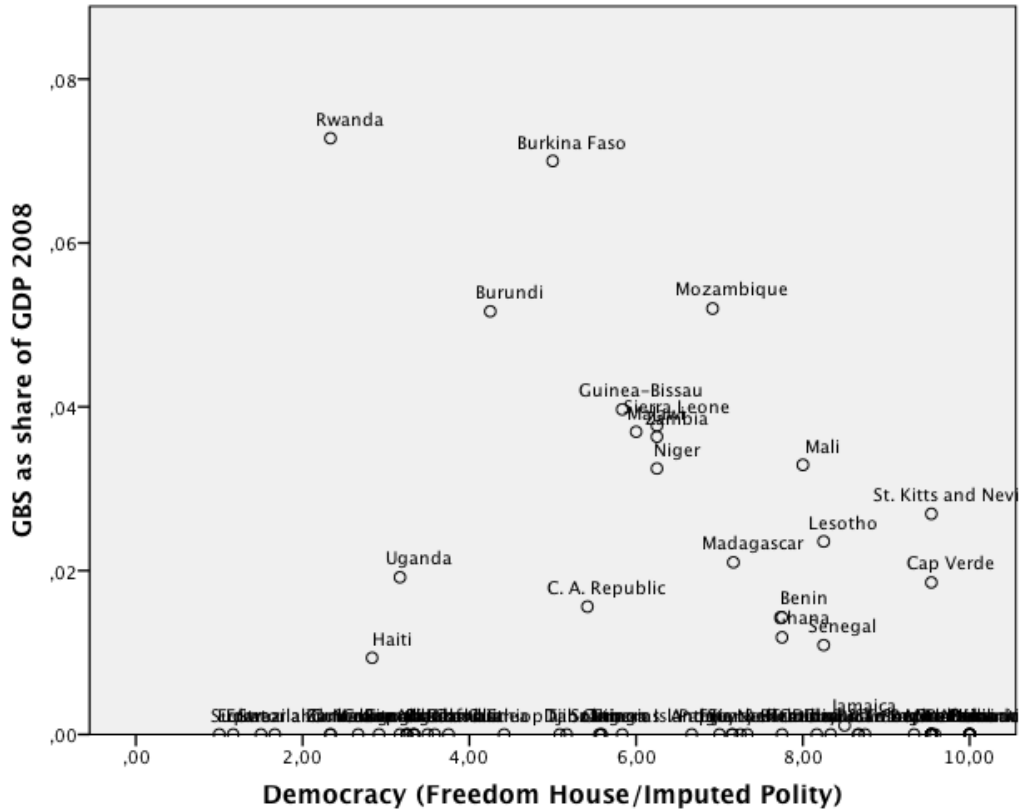


Figure 5. Scatter plot illustrating the relationship between the allocation of General Budget Support and Democracy.

The tendency discerned in the correlation analysis and depicted by the scatter plots is maintained when the results from the bivariate and multivariate regressions are summarized in the following two regression tables.¹⁹

¹⁹ Additional information, diagnostics and comments about the variables is found in Appendix B.

Table 2. Results from bivariate regressions. Dependent variable: General Budget Support as share of GDP. Unstandardized b-coefficients, standard errors within parentheses.

Variable	Coefficient
Control of Corruption	-0,003 (0,003)
Rule of Law	-0,004 (0,002)
Democracy	-0,001 (0,001)
Intercept	-
N	-
R ² (adjusted)	-

*** = $p < 0.001$ ** = $p < 0.01$ * $p < 0.05$ Sources: OECD, 2011a; United Nations Statistics Division, 2012; Teorell et al., 2011.

As depicted in the table above, the bivariate regressions did not display significant relationships between the variables, indicating that none of the three measures of institutional quality used determine the allocation of General Budget Support.

The lack of significant association between General Budget Support and control of corruption can be associated with risks related to moral hazard. The allocation of un-earmarked aid directly to a recipient government's national treasury may well be misused if the government is corrupt (Bräutigam, 2000; Bräutigam & Knack, 2004; Djankov et al., 2008; Goldsmith, 2001; Knack, 2001; Tavares, 2003). Furthermore, this can be seen as conflicting with the claim that General Budget Support is to be allocated to "good performers". The same goes for the lack of significant relationship with the variable measuring rule of law.

Recalling the discussion provided by North (1990), the allocation of General Budget Support to recipient countries that cannot uphold the rule of law, including the protection civil liberties and an independent judiciary, can be seen as associated with higher transaction costs and

thereby less development than would have been the case if a positive significant relationship would have been detected. Seen from this wider institutional perspective, this result indicates that General Budget Support may not be allocated in a way that maximizes the impact of aid. This is in line with the notion that the impact of aid depend on the quality of recipient institutions (Burnside & Dollar, 2000; Ear, 2007; Easterly & Pfitze, 2008; Wright, 2009) the results from the bivariate analyses are not overly optimistic.

The lack of significant association between allocation of General Budget Support and the level of democracy in recipient countries is similar to the finding of Svensson (1999). Following his argument, this result can be seen as aligned with his claim that strategic and political motives determine the allocation aid to a greater extent than the promotion of democracy. The lack of association with democracy could perhaps be seen as problematic in relation to the EU policy claim that respect for democracy and human rights is at the core of its development efforts (Official Journal of the European Union, 2006).

The lack of significant relationships is maintained in the multivariate regressions conducted. Model 1 refers to the bivariate regressions with the independent variables included one at a time as depicted in the previous table, model 2 to a regression with all three independent variables included simultaneously and model 3 to a regression that also includes the two control variables.

Table 3. Results from multivariate regressions. Dependent variable: General Budget Support as share of GDP. Unstandardized b-coefficients, standard errors within parentheses.

Variable	Model 1	Model 2	Model 3
Control of Corruption	-0,003 (0,003)	0,003 (0,005)	0,005 (0,005)
Rule of Law	-0,004 (0,002)	-0,007 (0,005)	0,001 (0,005)
Democracy	-0,001 (0,001)	0,001 (0,001)	0,002 (0,001)
Population (ln)	0,002* (0,001)	-	(0,000) (0,001)
Infant mortality	0,000*** (0,000)	-	0,000*** (0,000)***
Intercept	-	0,004 (0,008)	-0,020 (0,018)
N	-	75	73
R ² (adjusted)	-	-0,002	0,249

*** = p < 0.001 ** = p < 0.01 * p < 0.05 Sources: OECD, 2011a; United Nations Statistics Division, 2012; Teorell et al., 2011.

The multivariate regression thus does not display significant relationships between the variables, further indicating that the independent variables are not to be seen as determinants of the dependent variable. That is, the results obtained do not suggest that the various dimensions of institutional quality conceptualized by the independent variables influence the allocation of General Budget Support. Recognizing the potential role of the shortcomings of the data outlined in Appendix B, this result does not give support to the notion that institutional quality determines the allocation of General Budget Support.

The only significant regression coefficient in the multivariate regression is displayed for infant mortality, suggesting that the level of poverty in recipient countries does *not* matter for the allocation of General Budget Support.

In order to examine if recipients of General Budget Support display higher institutional quality than non-recipients, a comparison of the mean-scores of the independent variables between the two groups was made, followed by a t-test addressing the level of significance.²⁰ The results obtained indicate that there are no significant differences between the Cotonou-signatories that receive GBS and the ones that do not in terms of institutional quality. The (non-significant) means displayed by the non-recipients were generally *higher* than for the recipients, which could be seen as interesting.

4.1 Conclusion and discussion

At this time, it might be appropriate to revisit the research question posed earlier and answer it based on the results achieved. Does the institutional quality of recipient countries determine the allocation of General Budget Support? The findings of this thesis indicate that the institutional quality of recipient countries does not determine the allocation of General Budget Support. None of the institutional features from which other publications cited in this thesis have departed – control of corruption, rule of law and level of democracy – were significantly associated with the allocation of General Budget Support. The result was maintained when the control variables – level of poverty and population – were controlled for. A comparison of means between the recipients and non-recipients did not display any significant differences among the groups in terms of institutional quality.

The Conclusion of this thesis can thus be summarized as follows: There is no evidence that donors do allocate General Budget Support based on the institutional quality of recipient countries. The purpose of this thesis – to examine to what extent donors allocate General Budget Support to recipient countries with high institutional quality – can therefore be seen as fulfilled.

How are then the results obtained to be interpreted? Implications can be discerned in relation to previous research, theoretical claims by the main donor institutions and not least EU development policy.

In relation to previous research, the results could be interpreted as aligned with the theoretical framework associated with strategic, rather than altruistic, allocation of aid (Alesina and

²⁰ See Appendix C

Weder 2002; Boone 1996; Maizels & Nissanke, 1984; Schraeder et al, 1998; Riddell 2007; Svensson, 1999; Svensson, 2006; Dunning, 2004; Andersen et al, 2006; Dreher et al, 2006). However, important to underline is that the results presented in this thesis do not allow for any conclusions to be drawn on the actual motives behind such allocation in the context of General Budget Support.

Theoretically, General Budget Support is associated with increased aid effectiveness as it can enable recipient governments to pursue their own policies and thereby improve their own capacity and institutions (OECD DAC, 2006e). The results presented in this thesis does not indicate that General Budget Support is allocated to the recipients that display the highest institutional quality, indicating that all theoretical benefits of the method may not be fully realized. The fact that no relationship between institutional quality and General Budget Support could be detected may be seen as contradicting the donor claim that the aid modality is allocated to “good” recipients. This could in turn implicate that General Budget Support does not imply increased aid effectiveness. Following from this, it would perhaps not be unjustified for donors to downplay the claim that General Budget Support only is allocated to recipients with high institutional quality.

It is also plausible that inflows of General Budget Support to recipients with weak institutional quality may be associated with a greater risk for moral hazard (Bräutigam 2000; Goldsmith 2001) and removed incentives for recipient governments to increase their capacity (Miller & Falaschetti, 2001; Miller & Hammond, 1994; Bräutigam & Knack, 2004; Wright & Winters 2010; Djankov et al 2008; Goldsmith, 2001; Knack 2001; Tavares 2003) compared to inflows to recipients that display higher levels of institutional quality. Following this line of thought, the results obtained may be seen as problematic.

However, it is important to underline that no time aspect has been included in this study. Hence, no far-reaching conclusions can be drawn about the institutional quality in the recipient countries over time. It is plausible, yet outside the scope of this thesis, that the institutional quality of the recipients examined in this may have improved over time. This question could very well be addressed by further research.

The conclusion of this thesis may be seen as problematic in relation to the notion of institutions of recipients as determinants to aid effectiveness. It could also be seen as

problematic that ODA-resources with the explicit aim to support "good" recipients is not allocated based on institutional quality, when donors claim that this should be the case. If un-earmarked financial resources originating from tax-payers in donor countries will continue to be allocated to recipients without clear criteria, it could perhaps be an idea for the donor community to either consider introducing fixed eligibility criteria or to downplay the claim that General Budget Support is allocated to "good recipients" that respect democracy and display low levels of corruption.

For the case of the European Commission, the results do not explicitly contradict the existing policy on General Budget Support. However, the lack of significant relationships between allocation and institutional quality could be seen as problematic in relation to the policy claim that levels of democracy, human rights and governance in recipient countries needs to be satisfactory if Budget Support is to be allocated (European Commission, 2008a). From a donor point of view, the recipients of General Budget Support must have been considered eligible in *some* aspect. The lack of clear criteria makes it hard to follow the justification of the method – not least given the lack of significant differences between the recipients and the non-recipients.

Admittedly, the lack of significant relationship between institutional quality and allocation of General Budget Support may be seen as "acceptable" from a policy based point of departure, given the notion of non-fixed eligibility criteria (Koeberle & Stavreski, 2006) as a way to enable institutional improvements in poor performing recipient countries.

Do donors then practice what they preach when allocating General Budget Support? In terms of allocating it to "good performers", the answer would be negative. However, as illustrated by this thesis, the main problem may *not* be that donors do not practise what they preach – rather, that they are preaching two contradicting principles of allocation of General Budget Support at the same time: to allocate it to recipients with high institutional quality *but* that it may be justified to allocate it to poor performers as well in order to improve their institutional quality. This may have implications in terms of decreased aid effectiveness as well as donor credibility.

4.2 Directions for future research

This thesis has been addressing issues related to aid allocation and institutions by narrowing the standard definition of aid, ODA. Similar points of departure could contribute to shed light on the “input” as well as “output” side of General Budget Support. The results presented in this thesis would probably benefit from a further analysis in relations to the impact of General Budget Support, analysed over time. Do the institutions of recipient countries improve over time when General Budget Support is allocated? Does the method contribute to poverty reduction? Given that this thesis indicates that one of the main arguments in favour of General Budget Support as quoted by the main donor organizations – that it is allocated to recipients with good institutions – may not hold, the other main argument – that General Budget Support improves recipient institutions and that no fixed allocation criteria therefore are needed – could fruitfully be addressed.

A comparison between General Budget Support and “standard” ODA would also help to shed light over the presumed characteristics of the method. Furthermore: Do the results of this thesis hold when General Budget Support provided by other donors to other recipients is analysed? These questions could be addressed by quantitative as well as qualitative research designs. Aid allocation based on donor interest rather than institutional quality is likely to increase the risk of moral hazard, especially in the case of un-earmarked aid.

If aid effectiveness through increased focus on recipient institutions is to be further pursued by donors and recipients, empirical evidence in favour of the policy-based rationale of General Budget Support can be seen as necessary – not least in order to keep aid effectiveness and aid recklessness separated.

4.3 Epilogue

During the finalization of this thesis, on May 14th 2012 the development ministers of the EU adopted so called Council Conclusions stipulating new guidelines for General Budget Support – “The Future Approach to EU Budget Support to Third Countries” (Council of the European Union, 2012). This can be seen as an evidence of the relevance of the point of departure of this thesis.

The Council Conclusions reaffirms the Union's commitment to the method, but underlines that human rights, democracy and fight against corruption need to be further emphasized. It is stated that General Budget Support “shall only be provided when and where it is assessed that

there is trust that it (...) will be spent in accordance with shared objectives and values, in particular human rights, democracy and the rule of law (...)" (Council of the European Union, 2012, p. 2 paragraph 8). In fact, the very name of General Budget Support is modified into "Good Governance and Development Contracts". Furthermore, it is stated that "transparency and budget oversight will become an additional eligibility criterion" (ibid., p. 3, paragraph 14).

At a glance, and following the results presented in this thesis, these statements could be seen as motivated if the Union seeks to realize the full potential of General Budget Support and avoid providing it to dubious regimes. But is this "future approach" to General Budget Support then to be interpreted as a shift towards stricter eligibility criteria? The answer to this may not be given, as the Council Conclusions also state that "in all forms of budget support the EU will apply a tailor-made and dynamic approach to eligibility (...)" (Council of the European Union, 2012, p. 2, paragraph 6). Nevertheless, these Council Conclusions could provide a fruitful point of departure for future research in the field of General Budget Support.

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Appendix A

The 78 African, Pacific and Caribbean countries that have signed the Cotonou agreement

Angola
Antigua and Barbuda
Belize
Cape Verde
Comoros
Bahamas
Barbados
Benin
Botswana
Burkina Faso
Burundi
Cameroon
Central African Republic
Chad
Congo (Brazzaville)
Congo (Kinshasa)
Cook Islands
Côte d'Ivoire
Djibouti
Dominica
Dominican Republic
Eritrea
Ethiopia
Fiji
Gabon
Gambia
Ghana
Grenada
Republic of Guinea
Guinea-Bissau
Equatorial Guinea
Guyana
Haiti
Jamaica
Kenya
Kiribati
Lesotho
Liberia
Madagascar
Malawi
Mali
Marshall Islands
Mauritania
Mauritius
Micronesia
Mozambique
Namibia
Nauru
Niger
Nigeria
Niue
Palau
Papua New Guinea
Rwanda
St. Kitts and Nevis
St. Lucia
St. Vincent and the Grenadines
Solomon Islands
Samoa
Sao Tome and Principe
Senegal
Seychelles
Sierra Leone
Somalia
South Africa
Sudan
Suriname
Swaziland
Tanzania
Timor Leste
Togo
Tonga
Trinidad and Tobago
Tuvalu
Uganda
Vanuatu
Zambia
Zimbabwe

Appendix B

Description of the variables

Dependent variable

General Budget Support as share of Gross Domestic Product 2008 (*GBSofGDP*)

Data on GBS-allocation was extracted from the OECD DAC's Country Reporting System (CRS) database and the OECD.STAT browser.²¹

GBS data was extracted from the database using the following criteria:

Donor: "EU-institutions"

Sector: VI:1. "510, General Budget Support, total"

Recipient: [*country of choice*]

Year: 2008 (The year 2008 was chosen because it is relatively recent and GBS-allocation was highest this year compared to the other years of available data).

GBS is expressed in constant prices (USD 2009).¹⁸

Data on GDP for the countries that receive GBS was taken from the United Nations Statistics Division's (UNSTAT) National Accounts Main Aggregates Database. GDP is expressed in constant prices (USD 2005).²²

Independent variables

The independent variables are extracted from the Quality of Government Dataset (Teorell et al., 2011.). SPSS diagnostics showed the independent variables to be normally distributed. Higher scores correspond to better outcomes and thereby higher institutional quality.

Rule of Law (qog_wbgi_rle)

Cross-section, 2002-2006 (varies by country).

Based on the World Bank's 'Worldwide Governance Indicators (WGI)', more info available at <http://info.worldbank.org/governance/wgi/index.asp>.

Definition from the QoG codebook (p. 70): "Rule of Law" includes several indicators which measure the extent to which agents have confidence in and abide by the rules of society. These include perceptions of the incidence of crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts. Together, these indicators measure the success of a society in developing an environment in which fair and predictable rules form the basis for economic and social interactions and the extent to which property rights are protected."

Control of Corruption (qog_wbgi_cce)

Cross-section, 2002-2008 (varies by country)

Based on the World Bank's 'Worldwide Governance Indicators (WGI)'.²³

²¹ The browser can be accessed at http://www.oecd.org/document/0/0,2340,en_2649_34447_37679488_1_1_1_1,00.html (2012-05-17).

²² The data is available at <http://unstats.un.org/unsd/snaama/dnllist.asp> (2012-05-17).

²³ More info available at <http://info.worldbank.org/governance/wgi/index.asp> (2012-05-17).

Definition from the QoG codebook (p. 70): “Control of Corruption” measures perceptions of corruption, conventionally defined as the exercise of public power for private gain. The particular aspect of corruption measured by the various sources differs somewhat, ranging from the frequency of “additional payments to get things done”, to the effects of corruption on the business environment, to measuring “grand corruption” in the political arena or in the tendency of elite forms to engage in “state capture”.

Democracy (qog_fh_ipolity2)

Cross-section: 2002-2006 (varies by country)

Based on data from Freedom House, more information available at <http://www.freedomhouse.org/>

Description from the QoG codebook (p. 46): ”Scale ranges from 0-10 where 0 is least democratic and 10 most democratic. (...) Imputed values for countries where data on Polity is missing by regressing Polity on the average Freedom House measure.”

Control Variables

Extracted from the QoG dataset (Teorell et al., 2011).

Population (ln_qog_wdi_pop)

Based on the World Bank's World Development Indicators.

(Cross-section: 2002-2004 (varies by country). The original variable was log-transformed due to skewness.

Description from the QoG codebook (p. 158): ”The de facto definition of population, which counts all residents regardless of legal status or citizenship, except for refugees not permanently settled in the country of asylum, who are generally considered part of the population of their country of origin. The values shown are midyear estimates.”

Infant mortality (qog_wdi_mort)

Cross-section: 2000-2002 (varies by country).

Description from the QoG codebook (p. 177): ”Infant mortality rate is the number of infants dying before reaching one year of age, per 1,000 live births in a given year.”

T-test variable: Recipient of GBS (GBSrecipient)

Constructed so that 1 = No GBS, 2 = GBS recipient

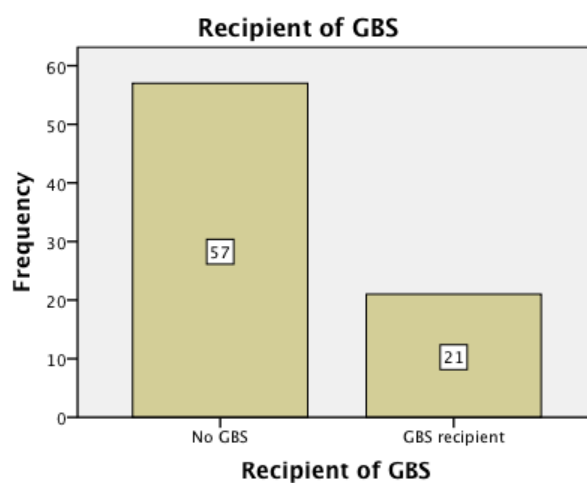


Figure 6. Illustration of GBS-recipients in relation to non-recipients among the signatories of the Cotonou agreement.

Table 4. Summary of variables

Variable	N	mean	std. dev.	min	max
GBS/GDP	78	0,0081	0,01669	0,00	0,07
Control of Corruption	75	-0,4241	0,67703	-1,70	1,44
Rule of Law	76	-0,4187	0,82480	-1,95	1,75
Democracy	76	6,4404	2,76893	1,00	10,00
Population (ln)	74	14,5089	2,15407	9,90	18,69
Infant Mortality	74	67,7814	39,37695	5,70	151,11
Recipient of GBS (yes/no)	74	1,269	0,4464	1,00	2,00

Multicollinearity

The independent variables were tested for multicollinearity, which means that two or more of the variables are correlated with each other (Hamilton, 1992). If the independent variables are correlated to a too high extent, it may not be possible to discern the separate effects on the dependent variable. The correlations illustrated in table 5 indicate that the independent variables are significantly correlated. This may be seen problematic yet acceptable, given that they have been chosen to represent the overarching notion of institutional quality. In line with the results obtained from the regressions, no significant correlations are displayed between GBS as a share of GDP and the independent variables. It can also be noted that there is a positive correlation between GBS as a share of GDP and the control variables.

Heteroscedasticity and distribution of errors

According to Hamilton (1992), heteroscedasticity may lead to inefficiency and biased standard error estimates. Heteroscedasticity implies that the errors may not have constant variance. For the dependent variable, the residuals are plotted against the predicted values below. Figure 7 on the next page indicates that the residuals may vary more when predicted allocation of General Budget Support is high. It also indicates that errors may not be normally distributed. The data used may have shortcomings in relation to the use of OLS regressions.

It was discovered that the variable based on the original values was somewhat skewed, meaning non-normally distributed and not ideal for regressions. In order to overcome this, logarithmic transformation of the variable was conducted. Given that many of the countries did not receive any General Budget Support, many of the values for this variable were zero. The value zero has no logarithmic value. Therefore, following the recommendations outlined in Hamilton (1992) and Osborne (2002), the constant 1.00 were added to the original value to move the minimal value to 1.00. The transformed variable was also slightly skewed. Therefore, the original variable was kept, as it was seen as corresponding with previous research to a greater extent than the transformed variable.

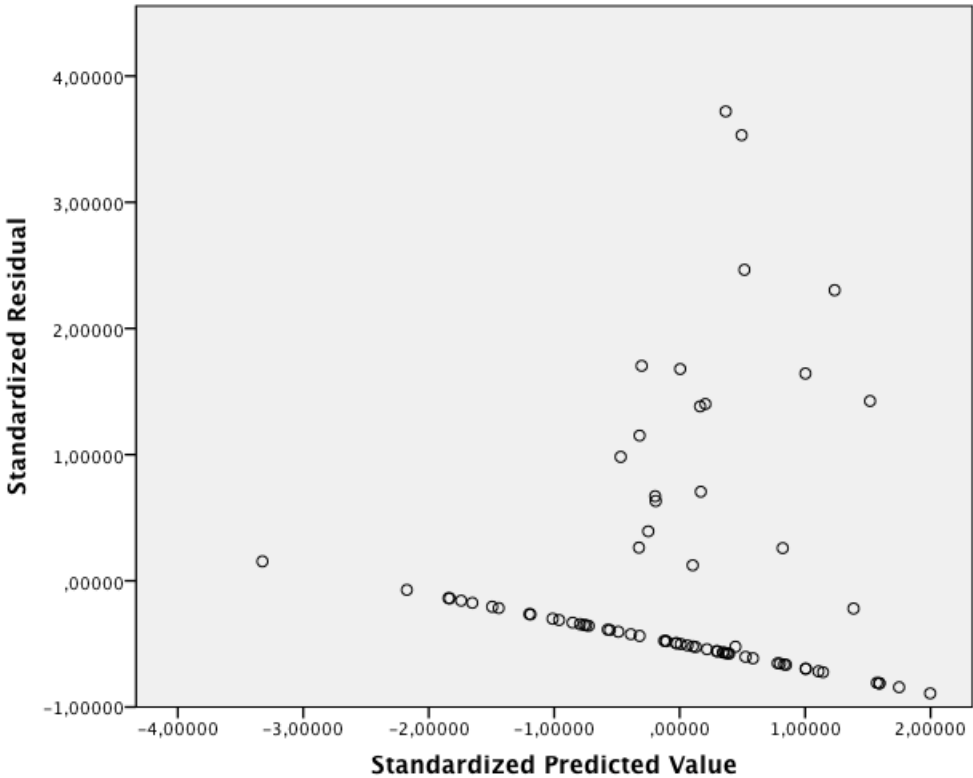


Figure 7. Predicted values plotted against residuals for the dependent variable.

Appendix C

Table 5. Comparison of means of institutional quality between recipients and non-recipients of GBS.²⁴

Group Statistics					
	Recipient of GBS	N	Mean	Std. Deviation	Std. Error Mean
Rule of Law - Estimate	No GBS	55	-,3384	,89908	,12123
	GBS recipient	21	-,6290	,55168	,12039
Control of Corruption - Estimate	No GBS	54	-,3591	,71903	,09785
	GBS recipient	21	-,5913	,53403	,11654
Democracy (Freedom House/Imputed Polity)	No GBS	55	6,4404	3,00988	,40585
	GBS recipient	21	6,4404	2,07145	,45203

²⁴ A t-test showed the differences between the groups to be insignificant.