Managing Reform: How Can the Baltic States as Aid Donors Best Share their Transition Experience with Less Advanced Economies and what Lessons Can they Learn from the International Development Programs of the Nordic Countries?

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Abstract

In spite of the global economic and financial crisis the Baltic States continue with their transition. According to the World Bank, Estonia and Latvia already are high income countries and Lithuania is an upper middle income country. All the Baltic States are members of key multilateral development institutions and have also established their bilateral development programs. Currently they are assisting and sharing their transition experience with countries further to the south and the east, including Belarus, Georgia, Moldova, Ukraine, etc. This article argues that small states can play an important role in economic development and the Baltic States can be important contributors since they have recent and relevant transition experience to share if they engage in policy dialogue with countries that are less advanced in their transition.

Keywords: *Small states, bilateral and multilateral development cooperation, budget support, policy dialogue, international financial institutions (IFIs)*

JEL classification: O10, O19, O20, O40.

1. Introduction

In spite of the global economic and financial crisis the Baltic States continue with their transition. The progress they have made since independence in 1991 has been remarkable. In about two decades those countries have been transformed from being centrally planned economies and part of the former Soviet Union, into modern countries that are firmly integrated into the global economy. Since independence they have become members of the European Union (EU), NATO and the World Trade Organization. (WTO)[2] They are also members of international financial institutions like the World Bank Group (WBG) and the European Bank for Reconstruction and Development (EBRD). According to World Bank classifications Lithuania is now an upper middle income country and Estonia and Latvia recently achieved a high income status (World Bank 2010a). In spite of

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[2] In addition to this, one of the Baltic States, Estonia is also a member of OECD and part of the Euro zone.

their increased international engagement the Baltic States have not yet become members of the regional development banks.[3]

Iceland's experience in economic development is also unique. In spite of its small size, limited capital and human resources, Iceland went through a transition from a colony to full independence in 1944. Before the World War II it was among the poorest countries in Europe. The current economic and financial crisis has hit its economy hard but Iceland remains a high income country. Iceland is not an EU member country but is a member of the European Economic Area (EEA) which unites the 27 EU member states and the three EEA EFTA States (Iceland, Liechtenstein, and Norway) into an internal market.[4] Like the Baltic States Iceland is a member of the WBG and EBRD but remains outside the regional development banks.

Nordic countries like Denmark, Norway and Sweden have also been affected by the economic and financial crisis but in spite of being relatively small countries they remain among donor countries that could be classified as leaders in development cooperation and are among few countries in the world who contribute more than 0,7 percent of their GDP to international development cooperation[5]. In addition to large bilateral development programs they are active members in the WBG, EBRD as well as in all the regional development banks.

When reconsidering and developing their aid programs it can be useful for the Baltic States and Iceland to review the experience of these neighboring countries to see what lessons can be learned from their experience. In fact multilaterally the Nordic Countries and the Baltic States cooperate extensively. At the World Bank Group the Baltic States share an Executive Director's Office with the Nordic Countries. This Nordic-Baltic cooperation also extends to the European Bank for Reconstruction and Development (EBRD). At the EBRD Iceland shares an office with Estonia and Sweden, Latvia works with Norway and Finland, and finally Lithuania works with Denmark.[6] (European Bank for Reconstruction and Development 2011). Nordic countries like Denmark, Norway and Sweden are leaders in international development cooperation and can as a group have an impact on development policy and approaches worldwide. The Nordic Countries could also benefit from the experience of the Baltic States who have recently implemented successful economic transitions.

The objective of this article is to assess what role small states can play in assisting their partner countries in their efforts to implement economic transition, achieve economic growth and poverty reduction. The countries focused on are mainly the Baltic States and Iceland. As discussed above all those countries are

[3] The regional development banks are the Asian Development Bank (AsDB), the African Development Bank (AfDB) and the Inter-American Development Bank (IDB).

[4] The internal market is governed by the same basic rules. These rules aim to enable goods, services, capital, and persons to move freely within the EEA in an open and competitive environment, a concept referred to as the four freedoms.

[5] In fact the only other countries that have achieved this status are the Netherlands and Luxembourg who also are small states.

[6] That group of countries also includes Ireland and FYR Macedonia.

participants in multilateral institutions and provide bilateral assistance to the partner countries they have selected. But how should they as small states assist their partner countries in the future? Should they focus on small bilateral projects or should they work in partnership with other bilateral and multilateral donors? Should they engage in budget support operations and participate in policy dialogue?

Asking those questions now may sound strange since the Baltic States and Iceland are still affected by the economic and financial crisis that started in 2008 and there may well be years of uncertainty and some difficulties ahead for those countries. However all these countries have their ongoing development cooperation programs and like larger countries they need to think about the effectiveness of the programs they support with their limited resources. In addition to this the Baltic States as new EU member states are currently challenged by their obligations as EU members to increase their contributions to international development cooperation. The target was to increase their ODA to 0.17% GDP by 2010 and 0.33% of GDP by 2015.

It seems clear that in the coming years the contributions of the Baltic States to international development cooperation will increase substantially, especially when their economies return to pre-crisis growth levels. In fact, the April 2011 World Bank EU10 Regular Economic Report projects economic growth recovery for all the Baltic States in the near future (World Bank, 2011).

Iceland is not an EU member but its parliament is for the first time considering a medium term plan from 2011 to 2014 for its development cooperation with the objective to contribute 0.23% of GNI to international development cooperation by 2014[7] (Alþingi, 2011).

2. Participation in international development cooperation - the Baltic states and Iceland

If one takes a look at the bilateral development assistance that the Baltic States provide, Estonia had prior to the current crisis already initiated its development cooperation and chosen Afghanistan, Georgia, Moldova and Ukraine as priority countries (Ministry of Foreign Affairs, Estonia, 2011). Latvia chose Belarus, Georgia, Moldova and Ukraine as its development cooperation priority countries (Ministry of Foreign Affairs, Latvia, 2011).

Lithuania selected Afghanistan, Azerbaijan, Belarus, Georgia, Moldova and Ukraine for its development cooperation and democracy promotion projects (Ministry of Foreign Affairs, Lithuania, 2011). While the global economic and financial crisis has affected the size of those bilateral programs, the Baltic States did the right thing.

[7] This goal is strange given that Iceland has applied for EU membership and new member states are expected to contribute 0,33% of their GDP to development coopertion by 2015. Iceland will thus in 2014 be far away from meeting the EU target for new member states.

They are sharing their experience with countries further to the south and the east, including some of their neighbors, and thus contributing to their transition and economic development and promoting peace and stability in the region they live in and are part of.

However what is unique with the selection of the priority countries of the Baltic States is that those are mainly middle income countries, see Table 1. This is common for EU10 countries but is very different from EU15 countries that emphasize low income countries, particularly in Sub-Saharan Africa.

Table 1. The Baltic States and their priority countries

Estonia: Development co-operation - priority partner countries		
Afghanistan	Low income	GNI per capita US$ 486
Georgia	Lower middle income	GNI per capita US$ 2.530
Moldova	Lower middle income	GNI per capita US$ 1.590
Ukraine	Lower middle income	GNI per capita US$ 2.800
Source: World Bank 2010a, Ministry of Foreign Affairs Estonia 2011.		

Latvia: Development co-operation priority countries		
Belarus	Upper middle income	GNI per capita US$ 5.540
Georgia	Lower middle income	GNI per capita US$ 2.530
Moldova	Lower middle income	GNI per capita US$ 1.590
Ukraine	Lower middle income	GNI per capita US$ 2.800
Source: World Bank 2010a, Ministry of Foreign Affairs Latvia 2011.		

Lithuanian: Priority partner countries		
Afghanistan	Low income	GNI per capita US$ 486
Azerbaijan	Upper middle income	GNI per capita US$ 4.840
Belarus	Upper middle income	GNI per capita US$ 5.540
Georgia	Lower middle income	GNI per capita US$ 2.530
Moldova	Lower middle income	GNI per capita US$ 1.590
Ukraine	Lower middle income	GNI per capita US$ 2.800
Source: World Bank 2010a, Ministry of Foreign Affairs Lithuania 2011.		

Iceland is currently focusing its bilateral programs on Africa. Its bilateral development cooperation is handled by the Icelandic International Development Agency (ICEIDA).

Until recently ICEIDA operated in six countries in three continents, i.e., in Malawi, Mozambique, Namibia, Nicaragua, Sri Lanka, and Uganda. Now ICEIDA operates only in three African countries, Malawi, Mozambique and Uganda, see Table 2.

The current priority sectors are natural resources (energy and fisheries), human resources (education and health), and peace (governance and reconstruction).[8]

[8] According to an email from ICEIDA dated May 27, 2011.

Table 2. Iceland's priority countries

Iceland: Partner countries		
Malawi	Low income	GNI per capita US$ 280
Mozambique	Low income	GNI per capita US$ 440
Uganda	Low income	GNI per capita US$ 460
Source: World Bank 2010a		

3. Project approach and budget support

For many years Iceland´s bilateral development agency ICEIDA has used the so called project approach and supported small projects in its partner countries. The project approach means that ICEIDA defines small sector specific projects, with an agreed timetable, in cooperation with the receiving country, but the financial administration of the project is maintained within ICEIDA.

This is increasingly out of line with the mainstream approach in international development cooperation as it is conducted today, emphasizing country ownership and using the planning, budgetary and procurement systems of the receiving/partner country.[9]

Internationally there is also an increased emphasis on budget support to recipient countries and in assisting them in creating an overall policy environment conducive to long-term economic growth.

Given the recent trends internationally one may ask the question whether or not the time has come for a small country like

Iceland to engage in policy dialogue with developing countries and provide a direct budget support in partnership with other donors, including small states, as well as international financial institutions.

Many donors, including the other Nordic Countries, are involved in budget support and use it as means to engage in policy dialogue with the developing country and to help the government of the receiving country to take the lead and ownership of the overall policy reform in the country.

One example of this is in Mozambique where the Nordic countries except Iceland provide budget support to the government. Iceland has a program in

[9] In 1980 the World Bank introduced its first structural adjustment loan which marked a shift from project aid to program based approach, where policy conditionality played an important role. Since then there has been a substantial shift in the international institutional environment for development cooperation and a number of important donor meetings have taken place, and declarations issued on aid effectiveness. Among those are: the Copenhagen Summit in 1995, the Millennium Development Goals from 2000, the Monterrey Consensus 2002, the Rome and Paris Declarations on Aid Efficiency from 2003 and 2005, and the Roundtables on Managing for Development Results (These roundtables were organized by the World Bank and took place in Washington DC 2002, in Marrakesh in 2004, and in Hanoi 2007). World Bank´s Comprehensive Development framework launched in 1999 is a notable change in the World Bank's development approach and the OECD DAC guidelines are also important. As a result, the key words in the current development paradigm are: ownership, alignment, harmonization, and results orientation. This has also resulted in increased emphasis on budget support to recipient countries and in creating an overall policy environment conducive to long-term growth.

Mozambique but it is limited to small projects only. In fact, according to a recent World Bank IEG PRSC evaluation the Nordic countries are among the biggest bilateral budget support providers in several African countries.

In 2007 Sweden was for example among top three bilaterals providing budget support to countries like Tanzania, Mozambique, Burkina Faso, Rwanda and Mali. The same year Norway was among the top 3 bilaterals providing budget support to Uganda and Malawi and Denmark was among 3 top bilaterals in budget support to Benin (World Bank, 2010b).

According to an unpublished ICEIDA Annual Report for 2010, work has been ongoing within the agency during the last years on reconstructing various aspects of its operations.

Cutting down on the number of partner countries and projects has been the main issue and in this process the emphasis was put on transferring as much of the execution and management of projects to local institutions as possible.

This process has reached various stages of completion in the partner countries but they are all undergoing changes of this kind.

The main purpose of these changes is to promote more efficient and successful development activities and promote local ownership and responsibility of all operations (Icelandic International Development Agency 2010).

Iceland has also applied for EU membership and in meetings with the EU different aid modalities and instruments have been discussed including projects, programmes and budget support.[10]

Although the Baltic States may initially use the project approach when they assist other countries they may soon also consider budget support and engage in policy dialogue.

This may be important for them also since they are as new EU member states committed to increase their ODA to 0.17% GDP by 2010 and 0.33% of GDP by 2015.

As the aid volumes increase project approach may become too time consuming and out of line with the practice used by other donors.

What distinguishes the Baltic States from the Nordic countries, including Iceland, is that their priority countries are mainly middle income countries where as the Nordic countries focus mainly on low income countries.

In fact the EU10 countries tend to support middle income countries whereas the EU15 countries focus on low income countries.

This makes sense for the Baltic States as they have recent transition experience to share that is particularly relevant for middle income countries and in their assistance they focus on priority transition issues, see Table 3.

However budget support operations like the PRSC´s that Nordic Countries have participated in only support low income IDA countries.[11]

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[10] According to an email from ICEIDA dated May 25, 2011 the budget support would be earmarked to sub-sectors and districts.

[11] IDA i.e. the International Development Association is the World Bank institution that supports the poorest developing countries.

Another World Bank Institution, IBRD,[12] that supports middle income countries provides budget support via Development Policy Loans (DPL). Donor harmonization is needed for both instruments, PRSC and DPL.

Table 3. Priority sectors/areas of the Baltic States in their partner countries

Estonia[13]	Latvia[14]	Lithuania[15]
(i) Education and health (human development); (ii) Good governance and democratization; (iii) Sustainable economic development (including environment); (iv) Horizontal field: ITC.	(i) Fostering market economy (international trade and DCFTA standards and requirements); (ii) Promoting good governance (civil society, local governments, state administration reforms); (iii) Environment; (iv) Education.	(i) Promotion of democracy; (ii) Rule of law and human rights; (iii) Economic development; (iv) Euro-integration processes; (v) Administrative capacity building.
Sources: Ministry of Foreign Affairs Estonia 2011, Ministry of Foreign Affairs Latvia 2011, Ministry of Foreign Affairs Lithuania 2011.		

4. Small donors and engagement in policy dialogue with partner countries

But does it make sense for small donors to shift from projects and provide a broad based support to their partner countries in cooperation with other larger donors? When analyzing the case of Austria and Ireland, both small states, and their participation in Programme-Based Approaches (PBAs) Laura Leyser "finds that a shift towards PBAs actually seems to be more important for small bilateral donors than for large ones" (Leyser, 2008). According to Leyser "PBAs enable small donors to 'punch above their weight' in terms of influence and to realise endeavors that would be impossible alone" (Leyser, 2008). Commenting on the Irish experience Leyser argues that "The most remarkable effect of Iris PBA engagement has been its lead position in most of the PBAs it participates. PBAs make Irish Aid "bigger" relative to its share of funding" (Leyser, 2008). The case of Ireland can be looked at as an example of a small country influence when working in partnership with other larger donors.

[12] IBRD i.e. the International Bank for Reconstruction and Development is the World Bank institution that supports middle income countries.

13 According to an email to the author from the Ministry of Foreign Affairs in Estonia dated April 25, 2011.

14 According to an email to the author from the Ministry of Foreign Affairs in Latvia dated April 26, 2011.

15 According to the website of the Ministry of Foreign Affairs in Lithuania accessed on April 27, 2011, available at: http://www.urm.lt/index.php?699487924

Small donors like the Baltic States and Iceland may still be uncertain whether or not to shift toward budget support due to their relatively small aid budgets and low capacities compared with larger donors. Small donors may be concerned that their voice will not be heard if they provide assistance in partnership with larger donors. They may fear the possible loss of identity and visibility.

But small donors can also have an advantage due to their comparatively neutral and not-threatening nature which may enhance their leadership credentials as other larger donors and governments are willing to support them. Small donors like the Baltic States and Iceland have no colonial ties. They can have important expertise. The Baltic States, for example, have recently implemented successful transitions and Iceland is an example of a small country that has, in spite of recent difficulties, managed to stay among the highest income countries in the world for many years. Small donors can also have an important role as brokers between larger donors and the partner country and facilitate harmonization. Leadership in a donor group by countries like the Baltic States and Iceland would hardly ever be considered threatening to any other donor country or the partner country receiving assistance.

For small donors projects can certainly allow them plant their flag and to better control the use of their money. But in the big picture of things, the impact of small projects may be quite marginal. Policy lending under a PRSC-like umbrella gives small donors a seat at the table for the policy dialogue. However, a small country would probably be most effective if it focuses only on a few key policy actions. A small donor country may also increase its impact by combining involvement in budget support with technical assistance for the ministries or agencies in charge of those key policy actions. The partner country receiving the technical assistance can then rely on the products of that technical assistance as an input in the policy dialogue, and on technical assistance program itself to deliver on the policy actions (e.g. drafting of a decree).

In a recent IEG evaluation of World Bank PRSCs the bank even complains that "Individual small donors can sometimes unduly influence the agenda" (World Bank, 2010b).

This study also notes that "Budget support groups often have uneven membership with a few large core donors and a large number of smaller donors, as well as nonfinancing members, which find it desirable to have a seat at the table" (World Bank, 2010b) and "in the case of Vietnam, donors complain that the Bank sometimes appears too demanding for small donors and suggests a more effective division of labor toward donors who have expertise in a sector" (World Bank, 2010b).

When participating in PRSCs small donors may thus be selective in the actions they propose and support those action with technical assistance to increase their impact. Small donors can thus influence beyond their monetary contribution if they are technically competent and well prepared. The World Bank and other IFIs should welcome such engagement.

5. Budget support and fiduciary risks

Some donors may be hesitant to engage in budget support because of the perceived fiduciary risks involved. But is there any reason to believe that budget support is necessarily more prone to corruption than investment projects? There seems to be no research that settles this issue unambiguously. To begin with, fiduciary risk seems hard to measure in any rigorous way. An Evaluation of General Budget Support (1994-2004) is the title of an independent report carried out by the University of Birmingham on behalf of more than thirty donor and partner countries. It was initiated and supported by the OECD´s Development Assistance Committee's Evaluation Network. According to the OECD

"The team of evaluators found no clear evidence that budget support funds were, in practice, more affected by corruption than other forms of aid" (OECD, 2006). Furthermore when discussing fiduciary risk Ritva Rainikka at the World Bank says "there is no clear evidence that the risk is greater for budget support than project aid" (Reinikka, 2008). Countries receiving budget support also often receive assistance to improve their financial managements systems and in fact according to the World Bank "To reduce fiduciary risks associated with budget support, PRSCs were intended to strengthen domestic budget processes." (World Bank, 2010b).

6. "Good" economic policy and economic growth

If a donor country that is using project approach decides to change its approach and get involved in budget support operations, in addition to the project approach, there needs to be some certainty, or at least a reasonable likelihood, that good economic policy and good governance leads to stronger economic growth, which in turn provides the basis for poverty reduction in the developing world. The war against poverty in the world will not be won in the long-term without economic growth.

The so called Washington Consensus attempted to summarize the outcome of the debate on what policy stances are conducive to economic development[16] (Williamson, 2000, Center for International Development, Harvard University, 2003). Although there is empirical evidence to support many of the policies in the Washington Consensus the IFIs were heavily criticized during the 1980s and the early 1990s for interpreting the policy prescription too literally, without country specific circumstances, institutional conditions, or effects on poverty.

There continues to be a debate about the relationship between good policy environment and economic growth. David Dollar and Craig Burnside published a famous article a decade ago where the case was made that aid had positive impact

[16] In its original formulation, the Washington Consensus prescribed a policy that could be summarized in ten propositions as follows: (i) fiscal discipline, (ii) a redirection of public expenditure priorities toward fields offering both high economic returns and the potential to improve income distribution, such as primary health care, primary education, and infrastructure, (iii) tax reform (to lower marginal rates and broaden the tax base), (iv) interest rate liberalization, (v) a competitive exchange rate, (vi) trade liberalization, (vii) liberalization of FDI inflows, (viii) privatization, (ix) deregulation (in the sense of abolishing barriers to entry and exit), (x) secure property rights.

on economic growth in countries with good economic policies (Burnside & Dollar, 2000). They concluded that making aid more systematically conditional on the quality of policies would likely increase its impact on developing countries growth. Other authors have been more cautious in concluding that aid promotes growth in countries with sound policies (see for example Easterly, Levine & Roodman, 2004) and emphasize that the seminal paper of Burnside and Dollar does not provide the final answer on this critical issue.

In 2005 James Adams, a former World Bank Country Director for Tanzania, published an article that discussed Tanzania's economic reform program under President Benjamin Mkapa. From 1995 to 2005 Tanzania grew 4.6 percent on an average annualized basis. According to Adams, "Tanzania's success with a set of Washington Consensus – inspired policies reflects, in (his) view, the tremendous importance of getting the economic fundamentals – fiscal discipline, low inflation, and market-driven exchange rates - right in any successful economic program" (Adams, 2005).

In his article Adams argues that the Washington Consensus provides very useful benchmarks for a successful economic reform program. He ends his article by stating "Let us hope that other developing countries in Africa can follow this model – and with equally successful results" (Adams, 2005). Thus Adams speaks strongly in favor of Washington Consensus principles and their applicability not only for Tanzania but for the African continent in general and presumably for other developing countries in the world.

In contrast another former World Bank Country Director, Edwin Lim, discussing China, argues that "there is no unique path to economic growth and poverty reduction. Each country has the opportunity and the need to determine its own strategy, depending on its own capacity and conditions (Lim, 2005).

Lim warns countries against following textbook prescriptions or external advice with inadequate considerations of their own capabilities and conditions. Furthermore Lim argues that too many economists still try to develop standard prescriptions for economic success and to advise countries without adequately understanding the country's capabilities and conditions.

According to Edwin Lim there are conditions without which sustained economic growth and poverty reduction seem impossible. One is a minimum level of basic human development - basic education and health for the bulk of the population. Another is a reasonable level of governance and of institutions. According to Lim these conditions are necessary but not sufficient for economic progress. And again Lim emphasizes the need for pragmatic approach, which is based on actual country conditions and capabilities (Lim, 2005).

The debate on the relationship between economic policies and growth is likely to be ongoing for a very long time, and it is safe to say that we do not know with any certainty which policies are most conducive to economic growth and poverty alleviation. However, while no one has found a "magic bullet" for growth there are some things that seem important, including sensible macroeconomic management[17]; laws and policies that create an environment conducive to private sector activity with low transaction costs; and an economy open for international trade (see for example Rajan, 2005). Investment in health and education also ought to be encouraged. The emphasis on macroeconomic stability and outward orientation in the Washington Consensus, have been and still remain, important components of sustainable development strategies.

7. Conclusions

The Baltic States have all successfully implemented major economic transitions during the last two decades. They are now firmly integrated in the global economy and are members of key international organizations including the EU, NATO, WTO, WBG and EBRD. They have also initiated their bilateral development programs and selected partner countries.

Small countries like the Baltic States cannot currently contribute large amounts of funds to international development cooperation. Their transition experience is however remarkable. Lithuania is now an upper middle income country, and Estonia and Latvia just reached high income status. Those countries can become important contributors to the policy dialogue in their partner countries where they can share their experience, successes and failures. In doing so, their influence and effectiveness could be enhanced by working in partnership with international financial institutions and other bilateral donors. Currently the Baltic States mainly assist middle income countries further to the south and east. The Baltic States can for example advise transition countries on public administration reform, institution building, European integration, etc.

It is possible that they will at some future point pay more attention to Africa like the Nordic countries have done, but this remains to be seen. The Baltic States already contribute to budget support operations through their EU membership. Due to EU commitments to increase their contributions to development assistance and projected economic growth in the next few years the aid volumes of the Baltic States are likely to increase substantially. Shifting some of their assistance from project approach to budget support is an option they need to consider.

Iceland still uses the so called project approach in its bilateral development cooperation and has so far been rather inactive in its cooperation with international financial institutions. Iceland is for the first time preparing a medium term plan (from 2011 to 2014) for its development cooperation with the objective to contribute 0.23% of GNI to international development cooperation by 2014. Iceland has a remarkable transitions experience to share.

Before the World War II it was one of the poorest countries in Europe and is now a high income economy. Iceland needs to consider providing assistance to developing countries beyond small projects that use the project based approach

[17] This would for example include: Fiscal discipline, moderate inflation, and a reasonable competitive exchange rate.

only. Iceland could engage in policy dialogue with developing countries in selected policy areas agreed to with the receiving countries. This is probably best done in partnership with international financial institutions and other like minded bilateral donors including the other Nordic countries that support the same partner countries. This would provide Iceland with an opportunity to try new approaches and better share its own experience in development and reconstruction with partner countries. Iceland's aid modalities are currently being discussed with the EU in relation to its application for membership. Participation in programme aid and budget support is part of the dialogue.

When small countries like Iceland and the Baltic States act alone their influence is likely to be rather limited. For small donor countries projects can certainly allow them plant their flag and to better control the use of their money. But in the big picture of things, the impact of small projects may be quite marginal. Policy lending under a PRSC-like umbrella gives small donors a seat at the table for the policy dialogue. However a small country would probably be most effective if it focuses only on a few key policy actions.

A small donor country may also increase its impact by combining involvement in budget support with technical assistance for the ministries or agencies in charge of those key policy actions. The partner country receiving the technical assistance can then rely on the products of that technical assistance as an input in the policy dialogue, and on technical assistance program itself to deliver on the policy actions.

Participation in budget support operations should not be seen as a panacea and does not guarantee success. General budget support instruments can however be very useful for dialogue on government wide policy issues and economic reforms in the recipient country. Provision of technical assistance, including in financial management, is necessary for developing and transition economies receiving budget support and can enable them to use government systems more effectively. Using project approach and budget support should not be seen as an either/or choice.

Both types of assistance can be used simultaneously and budget support could be introduced gradually especially for the recipient countries with the weakest country systems. To achieve poverty reduction in the long-term, sustainable economic growth is necessary. Budget support operations should support economic policies that are conducive to economic growth. It is unrealistic to relay only on redistribution of income to reduce poverty in the long-term without growth.

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