

How can the Baltic States as Non-DAC donors best contribute to international development cooperation?

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Abstract

Many non-DAC donors, including the Baltic States, have both growing development assistance programs and valuable transition experiences to share. On the other hand, DAC countries have decades of experience in developing good practices in aid delivery and can support other donors such as the Baltic States in improving their development co-operation programs. This article argues that the Baltic States can potentially better share their transition experience and increase their development impact by engaging in development cooperation in partnership with other donors and by participating in policy dialogue and budget support when possible and appropriate. The international community, including international financial institutions and DAC countries, should make more effort in utilizing the transition experience of the Baltic States when assisting less advanced transition countries in Eastern Europe and Central Asia.

Keywords: Non-DAC donors², DAC donors³, EU10⁴, EU15⁵, international development co-operation, international financial institutions, policy dialogue, budget support.

JEL classification: O20, O19, O40

1. Introduction and background

Many non-DAC donors, including the Baltic States, have both growing development assistance programs and valuable transition experiences to share. On the other hand, DAC countries have decades of experience in developing good practices in aid delivery and can support other donors such as the Baltic States in improving their development co-operation programs. But why should small countries like the Baltic States participate in international development cooperation? One answer is that European Union (EU) membership requires them to do so, and to become increasingly involved. In fact, under an EU decision of May 2005 they, like

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² Refers to donors who are not members of the Development Assistance Committee (DAC) of the OECD. Non-DAC members are not only the EU10 countries. In fact non-DAC donors comprise a diverse set of countries, which can be classified into four groups: (i) OECD countries that are not members of DAC, such as Mexico, Turkey and several European countries like Estonia, an EU member, and Iceland, which remains outside the EU; (ii) new European Union states that are not members of OECD such as Latvia and Lithuania; (iii) Middle Eastern OPEC countries such as Saudi Arabia; and (iv) non-OECD donors that do not belong to any of the previous groups, including emerging powers such as Brazil, China, India and Russia.

³ The 24 DAC donor countries are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Korea, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, the United States, and European Union Institutions.

⁴ The EU10 are the eight Eastern and Central European countries that joined the EU in 2004: the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia as well as Bulgaria and Romania joined the EU in 2007.

⁵ The EU15 countries are: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom.

other new EU member states, are to make their best endeavors to reach 0.17 percent of GNI by 2010 and 0.33 GNI by 2015 (See e.g. Manning 2006). Fortunately, in spite of difficulties from time to time, including during the global economic and financial crisis that still affects Europe, the Baltic States have been successful in their transition and are back on a growth track, see table 1.

Table 1. Projected growth rates in the Baltic States.

	2010	2011	2012
Estonia	3.1	3.7	3.9
Latvia	- 0.3	3.3	4.0
Lithuania	1.3	4.3	3.2

Source: World Bank 2011.

Estonia and Latvia are classified by the World Bank Group as high income countries and Lithuania is very close to achieving high income status, see table 2. In addition to the moral obligation to share their success and support other less advanced countries they can also contribute to stability and prosperity in the region they live in by contributing to development cooperation. In fact, development co-operation remains an essential instrument for achieving a better, more inclusive globalization process that benefits all countries and peoples.

Table 2. The Baltic States population and per capita income.

Estonia	Population 1.3 m	High income	GNI per capita US\$ 14,060
Latvia	Population 2.3 m	High income	GNI per capita US\$ 12,390
Lithuania	Population 3.3 m	Upper middle income	GNI per capita US\$ 11,410

Source: World Bank 2010a.

Notes: Million (m), Gross National Income (GNI).

Obviously small countries like the Baltic States have limited human capital and financial resources. Nevertheless they have implemented successful reforms. Since independence they have been able to achieve many goals that other European countries further to the south and east have not been able to do so far. When assisting other countries they could draw on the experience of staff who are currently active in the government as well as retired staff who were engaged in reforms after independence and prior to EU accession. Individuals from the private sector, academia, and elsewhere, should also get involved. In this effort the Baltic States should not only share their success stories in development. They should also discuss some controversial issues e.g. problems encountered during privatization of state assets, the fight against corruption, and others. The Baltic States can in the future play an increased role in the international arena when it comes to aid delivery. They can take prestige in leading internationally. This, however, must be done selectively taking into account their budget, human capacity and also depending on needs and their comparative advantages in each case.

2. The Baltic States - Partner countries and priority sectors

All the Baltic States have initiated their aid programs. Their current aid flows are channeled to their neighboring countries in Europe and Central Asia. These are not typical North-South flows as from rich OECD countries to the poorest countries in the south. If one looks at the

bilateral development assistance that the Baltic States provide, Estonia chose 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). The Baltic States are thus sharing their transition experience with countries further to the south and east. What is also unique about their selection of priority countries is that they are mainly middle income countries and not the poorest countries in the world, see table 3.

Table 3. The Baltic States and their priority countries.

Estonia: Development co-operation - priority partner countries			
Afghanistan	Population 29.8 m	Low income	GNI per capita US\$ 486
Georgia	Population 4.3 m	Lower middle income	GNI per capita US\$ 2,530
Moldova	Population 3.6 m	Lower middle income	GNI per capita US\$ 1,590
Ukraine	Population 46.0 m	Lower middle income	GNI per capita US\$ 2,800
Latvia: Development co-operation - priority countries			
Belarus	Population 9.7 m	Upper middle income	GNI per capita US\$ 5,540
Georgia	Population 4.3 m	Lower middle income	GNI per capita US\$ 2,530
Moldova	Population 3.6 m	Lower middle income	GNI per capita US\$ 1,590
Ukraine	Population 46.0	Lower middle income	GNI per capita US\$ 2,800
Lithuania: Priority partner countries			
Afghanistan	Population 29.8 m	Low income	GNI per capita US\$ 486
Azerbaijan	Population 8.8 m	Upper middle income	GNI per capita US\$ 4,840
Belarus	Population 9.7 m	Upper middle income	GNI per capita US\$ 5,540
Georgia	Population 4.3 m	Lower middle income	GNI per capita US\$ 2,530
Moldova	Population 3.6 m	Lower middle income	GNI per capita US\$ 1,590
Ukraine	Population 46.0 m	Lower middle income	GNI per capita US\$ 2,800

Sources: World Bank 2010a, Ministry of Foreign Affairs Estonia 2011, Ministry of Foreign Affairs Latvia 2011, Ministry of Foreign Affairs Lithuania 2011.

3. The EU15 DAC versus the EU10 Non-DAC

In international development cooperation a clear divide exists within the EU. All EU15 countries are also DAC members and all EU10 countries are Non-DAC members. The EU15 countries increasingly support low income countries especially in Sub-Saharan Africa while the EU10 countries mainly support less advanced middle income countries in Europe and Central Asia. Within DAC there is some recognition of the role and the importance of Non-DAC countries. An example of this are recent DAC Guidelines and Reference Series entitled: “Harmonising Donor Practices for Effective Aid Delivery” where one can find the following statement: “In recent years, the DAC has strengthened its relations with other providers of development assistance from within and outside the OECD, many non-DAC members have rapidly growing assistance programmes, and have valuable development experiences and innovative approaches to share. The DAC recognises that it has much to learn from these experiences and approaches. At the same time, the DAC can draw on decades of work on good practices in aid to support other donors in improving their development co-operation programmes. Stronger dialogue and better information flows can enhance understanding among all donors, and can make the DAC’s work more relevant and effective in achieving its goals.

The DAC engages with other providers of development assistance by organising events with them, inviting them to participate in its official and technical discussions, and helping them improve their aid statistics and management systems” (OECD 2010, p. 30). In the case of the Baltic States it seems clear that their transition experience can benefit the EU when it implements further enlargement to the south and east. The Baltic States also have recent and valuable experience in working both with multilateral and bilateral donors and in coordinating assistance from the recipient side. On the other hand EU15 DAC donors have long experience in aid delivery and have worked on aid effectiveness for decades. On that front the Baltic States can benefit from working in partnership with EU15 DAC members.

Currently the Baltic States mainly support projects in their partner countries e.g. technical assistance or capacity-building projects, and focus their assistance on priority transition issues, see table 4. The project approach often means that the donor country defines sector specific projects, with an agreed timetable, in cooperation with the partner country, but the financial administration of the project is maintained by the donor. This is increasingly out of line with the mainstream approach in international development cooperation as it is conducted today, emphasizing country ownership⁶ and using the planning, budgetary and procurement systems of the receiving/partner country. Internationally, increased emphasis is also placed on budget support to recipient countries and in assisting them in creating an overall policy environment conducive to long-term economic growth.⁷

Given these trends internationally, one may ask whether the time has come for smaller countries such as the Baltic States to engage in policy dialogue with their partner countries and provide direct budget support in partnership with other donors, including international financial institutions. Many donors, such as the Nordic Countries, provide budget support and use it as means to engage in policy dialogue with developing countries and to help the governments of receiving countries to take the lead in and ownership of overall policy reform in their country. 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 the top three bilaterals providing budget support to countries like Tanzania, Mozambique, Burkina Faso, Rwanda and Mali. The same year Norway was among the top three bilaterals providing budget support to Uganda and Malawi and Denmark was among the three top bilaterals in budget support to Benin (World Bank 2010b).

⁶ Successful development or economic transition depends on local ownership, local involvement and adaption to local conditions. The term “ownership” is used to describe countries’ choice of and commitment to reforms, as opposed to their reluctant acceptance.

⁷ In 1980 the World Bank introduced its first structural adjustment loan which marked a shift from project aid to a program-based approach, where policy conditionality played an important role. Since then a substantial shift has occurred 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). The World Bank 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.

Table 4. Priority sectors/areas of the Baltic States in their partner countries.

Estonia*	Latvia**	Lithuania***
(i) Education and health (human development); (ii) Good governance and democratization; (iii) Sustainable economic development (including the environment); (iv) Horizontal field: ITC.	(i) Fostering market economy (international trade and DCFTA standards and requirements); (ii) Promoting good governance (civil society, local government, state administrative 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 Estonia 2011.

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

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

*** 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>

Although the Baltic States initially used the project approach, they may soon also want to consider budget support and engage directly in policy dialogue with their partner countries. As their aid volumes increase, the project approach may become too time consuming and out of line with the practice used by other donors. The Baltic States need to consider donor behavior encouraged in the Paris Declaration of 2005. This emphasizes the importance of ownership by partner/recipient countries, alignment by donor countries of their aid to support local priorities and delivery channels when these meet adequate standards, harmonization and simplification of donor procedures, a stronger focus on achieving results by both partner/recipient countries and donors, and greater mutual accountability for these results. The fact that the Baltic States have limited financial resources should not necessarily exclude them from participating in budget support operations. As a recent Green Paper from the European Commission states: “Budget support must be more than a financial transfer – it is part of a package including policy dialogue, performance assessment, capacity-building and other supporting interventions” (European Commission 2010, p. 6). There is no reason why smaller countries who have been successful in many transition areas cannot contribute to policy dialogue in less advanced countries that are undergoing similar reforms. Furthermore the Baltic States are already engaged in capacity-building and technical assistance in their partner countries and could continue to do so while contributing to budget support operations in partnership with other donors.

The objective of this study is to answer the question: How can the Baltic States as Non-DAC donors best contribute to international development cooperation? This question has two dimensions. First, how can the Baltic States maximize the development impact their limited aid budget can have in their chosen partner countries? Second, how can the transition experience of the Baltic States be best utilized for the international community to promote transition in less advanced transition countries? This should not only be of interest to the Baltic States but also the international community as a whole and in particular for the European Union, which wants stability and prosperity in Europe and Central Asia and is in the process of expanding its membership in Europe.

4. Definitions and some theoretical and empirical considerations

One way for the Baltic States to better share their transition experience is to become more active in policy dialogue with their partner countries. This could be done by shifting some resources from the small projects⁸ currently dominating their aid programs to provision of budget support in partnership with other donors. As Koeberle and Stavreski note in a World Bank publication titled: *Budget Support as More Effective Aid? Recent Experience and Emerging Lessons*, “Budget support has become an increasingly important mode of development assistance, receiving growing attention from bilateral donors and international financial institutions in the context of a partnership-based approach to aid. This form of aid promises benefits for both donors and recipient countries: increasing scope for scaling up development assistance, reducing transaction costs, strengthening country ownership, and achieving greater development effectiveness than traditional modes of aid delivery.” (Koberle and Stavreski 2006, p. 3). This is especially noteworthy for the Baltic States as their comparative advantages lie in sharing their recent transition experience with less advanced transition countries. Policy advice cannot only be prescriptive and based on standardized development models but should assist countries in developing their own solutions for applying principles that have been recognized as valid development approaches. Consultations with transition countries, like the Baltic States, that have recently implemented similar reforms can aid in this process that needs to be undertaken by less advanced transition countries.

But what exactly is budget support? A variety of definitions can be found. In a recent World Bank publication Koberle and Stavreski define budget support as “financial assistance that supports a medium-term program and is provided directly to a recipient country’s budget on a regular basis, using the country’s own financial management systems and budget procedures” (Koberle and Stavreski 2006, p. 3). According to OECD DAC Guidelines and Reference Series, budget support is 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. The funds thus transferred are managed in accordance with the recipient’s budgetary procedures” (OECD 2006, p. 26). According the European Commission, “Budget support is a way of implementing development aid which consists in giving financial aid to the treasuries of the recipient countries. This aid increases the resources available to the recipient country to implement its own budget according to its own procedures. What generally characterises budget support is that it goes directly to the partner governments and is integrated into their own systems of appropriation, procurement and accounts, and is not connected to specific projects” (European Commission 2008, p. 15).

Common to all these definitions is the notion of direct financial support to the partner country’s budget. Given the current size of the Baltic economies these transfers cannot be large in absolute terms but they would allow the Baltic States to participate in a broad based dialogue and share their transition experience. In fact many donors consider an opportunity for open

⁸ The effectiveness of project financing in developing countries has been questioned by many donors that are concerned about supporting many parallel systems outside the partner government’s budget framework, low disbursement rates, and limited impact. Participation in budget support operations allows donors to provide more strategic medium-term assistance in partnership with other donors.

dialogue on broad policy reforms to be one of the most important elements of budget support arrangements. As Koberle and Stavresky emphasize “Smaller bilateral donors, in particular, value the opportunity to contribute effectively to the dialogue on government policies.” (Koberle and Stavreski 2006, p. 20). It is important that policy dialogue between donors and the partner country is well informed and supported by well targeted analytical work and technical assistance. Here some of the small technical assistance and capacity building projects provided by the Baltic States could become more effective if they supported specific policy actions.

As the development aid budgets of the Baltic States grow according to their EU commitments and as their economies grow it will become increasingly difficult for the Baltic States to prepare small technical assistance and capacity building projects. This applies not only to EU10 countries like the Baltic States. This is an issue for all EU countries. As Louis Michel - then the European Commissioner for Development and Humanitarian Aid - recently put it: “The doubling of the volume of development aid adds a completely new dimension to the debate about project aid versus budget support. If this were to be translated into a doubling of projects the situation would quickly become chaotic and unmanageable for our development partners” (European Commission 2008, p. 4). He concludes by saying “Budget support and more of it is the only answer. For this reason I have decided to increase the proportion of budget support from 20 % of our funding to 50 %” (European Commission 2008, p. 4).

Some donors may be hesitant to engage in budget support because of the perceived fiduciary risks involved. In a recent Green Paper the European Commission, as one of the largest providers of budget support in the world, stated that “Corruption is one of the key factors that affect the balance of arguments for and against budget support. Failure to tackle corruption undermines confidence in both the budget and the wider political economy, and has implications for both financial and development risks” (European Commission 2010, 13). There can be no doubt about the serious consequences corruption has for development. But are there any good reasons to believe that budget support is 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 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 2006b, p. 1). Furthermore when discussing fiduciary risk Ritva Reinikka at the World Bank says “there is no clear evidence that the risk is greater for budget support than for project aid” (Reinikka 2008, p. 193). 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, p. xiii). Currently the EU 15 DAC countries and the European Commission are large budget support providers. However their aid programs increasingly focus on low income countries especially in Sub-Saharan Africa.

The World Bank has developed poverty reduction support credits (PRSCs).⁹ Those credits that typically consist of a series of three or four single-tranche operations are targeted to low income well-performing countries with credible poverty reduction strategies. EU 15 countries and the European commission have often co-financed PRSCs and participated in policy dialogue with the receiving countries. The transition experience of the Baltic States is however most relevant to less advanced middle income countries. The international community including the EU and the World Bank should consider engaging the Baltic States and other new EU member states more in reforming those economies and provide a venue for them to participate via instruments such as Development Policy Loans (DPLs) currently provided by the World Bank in some of their middle income partner countries. This would allow the international community to better utilize the recent transition experience and expertise that these new EU members can bring to the table. New EU10 member states often have comparative advantages over the older EU15 member states in reforming middle income countries since they have recently implemented such transition themselves. This would allow the Baltic States to engage more effectively in dialogue on key cross-cutting transition issues with their partner countries, such as public sector reform, public financial management, improvements in governance, and the like. Such engagement would be based on an agreed set of performance indicators in the form of institutional or policy reform measures or outcome indicators.

5. The importance of policy dialogue and the role of smaller states as aid donors

Even with commitments to increase their aid as a share of GNI, as well as their growing economies, absolute amounts of aid from the Baltic States will be small given their economic size. However their contribution to policy dialogue with transition economies does not have to be small. In fact, a need exists for improved dialogue among all providers of international development cooperation, where budget support can be an effective instrument for development. This aid instrument enables partner countries receiving assistance to make decisions about their own choices. With project aid there is often the temptation to interfere in the partner country's choice of priorities. Budget support in partnership with international organizations and other bilateral donors gives meaning and depth to the dialogue between partners and international donors. The budget reflects the partner government's fundamental policy choice and priorities. It is a statement of its objectives.

Transition countries should be encouraged to take the lead in this process and the role of donors should only be supportive. It is important to have a real policy dialogue between donors and beneficiaries. But does it make sense for small donors like the Baltic States to shift from their current projects and provide broad based support to their partner countries in cooperation with other much larger donors? When analyzing the cases 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, p. 2). 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, p. 34).

⁹ Under PRSC a Poverty Reduction Strategy Paper (PRSC) defines an overarching framework for collaboration.

Commenting on the Irish experience Leyser argues that “The most remarkable effect of Irish 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, p. 3). The case of Ireland can be looked at as an example of a smaller country’s influence when working in partnership with other larger donors.

Small donors like the Baltic States 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 non-threatening nature. This may enhance their leadership credentials as other larger donors and governments are willing to support them. Small donors like the Baltic States have no colonial ties. They can have important expertise. The Baltic States, for example, have recently implemented successful transition. 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 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 to plant their flag and to better control use of their money. But in the bigger 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 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 technical assistance can then rely on the products of that technical assistance as an input in policy dialogue, and on the technical assistance program itself to deliver on policy actions (e.g. drafting 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, p. 43). 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, p. 48) 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, p. 56). When participating in PRSCs small donors may thus want to be selective in the actions they propose and support those actions with technical assistance to increase their impact. Small donors can thus exercise an influence beyond their monetary contribution if they are technically competent and well prepared. The World Bank and other IFIs should welcome such engagement.

6. Economic policy and growth

If a donor that is mainly using the project approach decides to get involved in budget support operations, instead of, or 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. Of course growth is not an end in itself but it makes it possible to achieve other important objectives such as additional resources for health care, education, etc in the partner country. The Washington Consensus attempted to summarize the outcome of a debate on what policy stances are conducive to economic growth and development¹⁰ (see Williamson 2000, Center for International Development, Harvard University 2003). Although empirical evidence supports many of the policies in the Washington Consensus, international financial institutions were heavily criticized during the 1980s and early 1990s for interpreting those policy prescriptions too literally, without country specific circumstances, institutional conditions, or effects on poverty.

The relationship between a good policy environment and economic growth continues to be debated. David Dollar and Craig Burnside published a famous article more than a decade ago where the case was made that aid had a positive impact on economic growth in countries with good economic policies (Burnside and 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 and Roodman 2004) and emphasize that the seminal paper of Burnside and Dollar does not provide the final answer on this critical issue.

The debate on the relationship between economic policies and growth goes on 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 management¹¹; 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.

In 2008 the so called Commission on Growth and Development¹² issued a report entitled: *The Growth Report - Strategies for Sustained Growth and Inclusive Development*. The report identified some of the distinctive characteristics of high growth and asked how other countries can emulate them. This report drew inspiration from economies that had been able to sustain growth at an average of 7 percent or more for 25 years or longer. Those successful economies

¹⁰ 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.

¹¹ This would for example include: Fiscal discipline, moderate inflation, and a reasonable competitive exchange rate.

¹² The Commission on Growth and Development consisted of 19 well-known and experienced policy, government, and business leaders, mostly from the developing world, and two Nobel laureates in economics.

had five common features that were summarized in a report that followed in 2010¹³: (i) they fully exploited the world economy, (ii) they maintained macroeconomic stability, (iii) they mustered high rates of investment, (iv) in allocating resources, these economies paid due respect to market signals, and (v) as a complement to these functioning markets, the successful economies also had committed, credible and capable governments. As the commission stated, these characteristics are easy to identify but it is harder to know how to replicate them in new places and new circumstances. In fact the commission stated that it “does not provide a formula for policy makers to apply – no generic formula exists” (Commission on Growth and Development, 2008 p. 2). According to the report, governments should be pragmatic in their pursuit of high growth and the Commission stated that “If there were just one valid growth doctrine, we are confident we would have found it” (Commission on Growth and Development, 2008 p. 4). The report encourages governments to pursue experimental growth to implementation of economic policy and cites Deng Xiaoping: “cross the river by feeling the stones.” In its 2008 report the commission stated that growth can be explained and expressed the hope that it can be repeated. The report was written just before the crisis and in a follow up report in 2010 the commission acknowledged that two ingredients that needed most rethinking were financial reform and export promotion. However the commission was of the view that the growth model in the original report still remained the best strategy to follow. (Commission on Growth and Development, 2010). According to the Commission on Growth and Development, some guidelines exist on what constitutes good economic policy. Those guidelines summarized by the commission can presumably be used both by governments implementing reforms as well as by donors supporting reforms and engaging in policy dialogue with partner governments.

¹³ Each of those five common features were described as follows by the Commission on Growth and Development as in a follow up report that was published in 2010 titled: Post-Crisis Growth in Developing Countries:

1. “ They fully exploited the world economy. They imported ideas, knowhow, and technology from the rest of the world. At the same time, they produced goods that met global demand, allowing them to specialize and expand rapidly without saturating the market.
2. They maintained macroeconomic stability. They kept a grip on inflation and did not stray down unsustainable fiscal paths.
3. They mustered high rates of investment, including public investment, financed by equally impressive rates of domestic saving.
4. In allocating resources, these economies paid due respect to market signals. This deference to the market was not absolute: in some cases, governments bent the law of comparative advantage, by favoring some industries over others. But even in these cases, the favored industries had to pass a market test by successfully exporting their products to foreign customers who did not have to buy them. And when the market gave its verdict, these economies were able to respond. Labor was relatively mobile, and stagnant industries were allowed to fail, creating space for more promising rival ventures. Governments recognized their duty to protect laid-off workers from economic misfortune. But they felt no obligation to preserve unviable industries, companies, or jobs.
5. As a complement to these functioning markets, the successful economies also had committed, credible, and capable governments. While market incentives and entrepreneurial dynamism are proximate drivers of growth, governments cannot be written out of the script. Their macroeconomic strategies and microeconomic regulations provide the setting in which market dynamics can work. Governments must also furnish a range of public goods, such as schooling and infant nutrition, that the market may under-provide. In successful countries, governments showed great perseverance in their pursuit of growth, experimenting with different country- specific growth strategies, and abandoning strategies that had outlived their usefulness, despite the upheaval this often entailed. They offered a credible vision of the future that justified sacrifices today in the expectation of rewards tomorrow. And they tried to distribute these rewards quite widely. They promoted equal opportunities as far as possible and narrowed unequal outcomes, not least because gross inequality can threaten the legitimacy of growth strategy. The somewhat chaotic microeconomics of structural transformation can create hardship and a skewed pattern of burdens and rewards. In successful growth strategies, the government works hard to ameliorate both”. (Commission on Growth and Development 2010, p. 1-2).

Another challenge worth mentioning, but not discussed in detail in this article, is for donors to be able to link specific aid programs with economic growth in their partner country. Poverty Reduction Support Credits (PRSCs) provided by the World Bank Group and frequently supported and cofinanced by other international organizations and bilateral donors, are a good example of budget support linked to policy reforms. A recent evaluation of PRSC programs stated that the “ultimate objective of PRSCs has been to support national development plans for achieving poverty-reducing economic growth. Assessing the contribution of PRSC operations to growth and poverty outcomes is difficult due to the fundamental problem of attribution. The PRSC is only one, typically small, element in a range of contributing factors.” (World Bank 2010b, xvi). This will also be a challenge for the Baltic States when and if they decide to engage in policy dialogue with their priority countries in partnership with other donors.

Conclusions

The Baltic States can potentially better share their transition experience and increase their development impact by engaging in development cooperation in partnership with other donors and by participating in policy dialogue and budget support when possible and appropriate. The international community, including international financial institutions, the EU15 and DAC countries, should make more effort in utilizing the transition experience of the Baltic States when assisting less advanced transition countries in Eastern Europe and Central Asia. The DAC should welcome a greater role for donors outside the DAC, including engagement of the Baltic States in their chosen priority countries.

Although the Baltic States initially used the project approach, they may soon also want to consider budget support and engage directly in policy dialogue with partner countries. As aid volumes increase, the project approach may become too time consuming and out of line with the practice used by other donors. The Baltic States need to consider donor behavior encouraged in the Paris Declaration of 2005, which emphasizes the importance of ownership by partner/recipient countries, alignment by donor countries of their aid to support local priorities and delivery channels when these meet adequate standards, harmonization and simplification of donor procedures, a stronger focus on achieving results by both partner/recipient countries and donors, and greater mutual accountability for these results. The international community including the EU and the World Bank should consider engaging the Baltic States and other new EU member states more in reforming less advantaged transition economies in Europe and Central Asia and provide a venue for them to participate via instruments such as Development Policy Loans (DPLs). This would allow the international community to better utilize the recent transition experience and expertise that these new EU members can bring to the table. New EU member states often have comparative advantages over the older EU15 member states in reforming middle income countries since they have recently implemented such transition themselves. This would allow the Baltic States to engage more effectively in dialogue on key cross-cutting transition issues with their partner countries, such as public sector reform, public financial management, improvements in governance, amongst others.

For small donors like the Baltic States projects can certainly allow them to plant their flag and to better control use of their money. But in the bigger 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 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 technical assistance can then rely on the products of that technical assistance as an input in policy dialogue, and on the technical assistance program itself to deliver on the policy actions (e.g. drafting decree). Small donors can thus influence budget support operations beyond their monetary contribution if they are technically competent and well prepared. The DAC, including EU15 countries, the World Bank Group and other IFIs should welcome such engagement. This should not only be of interest to the Baltic States but also the international community as a whole and in particular for the European Union, which wants stability and prosperity in Europe and Central Asia and is in the process of expanding its membership in Europe.

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