INTEGRATING AID INTO BUDGET MANAGEMENT

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Introduction

1. This paper discusses how traditional donor practices can cause problems for budget planning and management in aid dependent countries. It discusses recent attempts to reform the budget process, and the donor role in it. Based on this discussion, it concludes with some suggestions for a 'Code of Good Practice' for donors.

Donors as Part of the Problem

2. Public expenditure planning and management can become overwhelmed by the actions of donors, especially in countries heavily dependent on aid. The problems include:-

i. The proliferation of donor projects inhibits the building of local institutional capacity by absorbing staff time and resources in donor driven activity, which bypasses, and therefore undermines, normal Government processes.

ii. Inappropriate technical assistance can reinforce this, producing instant solutions which undermine the authority of local managers, who loose the opportunity to acquire the experience, skills and confidence to deal with problems, thereby perpetuating dependence on donors. Donor policy rightly stresses the capacity building objective, but in practice the desire for faster progress still leads to ‘do’ rather than to ‘facilitate’.

iii. Donor conditionality undermines politically accountable processes for determining priorities. The Cabinet may in practice be bound by Bank or Fund conditionality on sectoral shares. There has been increasing recognition in donor debates, notably in the SPA (Special Programme for Africa) that more account needs to be given to local democratic processes in framing conditionality, and more stress placed on consensus building and ownership: but practice has yet to change significantly. Collective prioritisation is replaced by an anarchic set of relationships in which donor officials and local sectoral interests may have disproportionate influence, and where no coherent national priorities can be addressed.

iv. The budget process for prioritisation is also undermined by donor willingness to negotiate directly at line ministry level, which leaves the Ministry of Finance unable to reject ministry proposals without declining aid offers. This is important if centrally determined priorities are arrived at by a politically accountable process of collective prioritisation, whereas line ministry decisions are more driven by sectoral interests and may not reflect national priorities.

v. Decisions taken on donor resources may also pre-empt decisions on the domestic budget. Many donors insist on counterpart contributions from the national budget. Most donor projects have recurrent cost implications for their operation and maintenance, costs which need eventually to be met from national resources.

vi. Donor preferences for financing capital items, and reluctance to support recurrent costs for fear of aid dependence, cause distortions where aid finances a large share of public expenditure. The capital budget becomes too large relative to the resources to operate and maintain what is built. The results are familiar: schools without books, clinics without drugs, roads which are continually ‘rehabilitated’ by donors after failure to fund routine maintenance caused their collapse, and an increasing burden on users to provide what the state budget can not. Attempts to find ways around the problems have eroded the distinctions between the recurrent and the development budget. In many countries in Africa, the development budget has become synonymous with what donors are willing to finance. At project level, it includes support for pay supplements for Government staff, and direct donor provision of a range of consumable inputs to keep facilities operating. It often includes financial support for recurrent inputs, via routes which by-pass the frustrations of Government approval and financial management procedures. This relieves immediate problems but undermines efforts to create sustainable capacity in Government. Much of this donor finance is outside Ministry of Finance approval, control, or knowledge, with little information provided by donors on their commitments or disbursements. In Tanzania, for example, less than half of the donor commitments reported to the DAC can be accounted for in terms of flows reported to Ministry of Finance.

vii. In the absence of a clear view of what resources are available, it is difficult for Government to make sensible choices regarding what services Government can afford to provide, to what standard. Donor project interventions are based on varying standards, and not usually tested against the long-term resources likely to be available. This leads to a pattern of provision both uneven and unsustainable.

viii. An important issue in assessing sustainability concerns the longer-term intentions, and short to medium term reliability, of donor commitments. The existence of donor support opens the possibility for Government to achieve today, helped by donor resources, a level of services which it could otherwise only aspire to at some future date when resources available to the economy have grown. There is a difficult judgement to be made, to avoid unnecessarily denying better health and education services to the present generation, whilst not creating an infrastructure which can not be sustained. The experience of Tanzania, which achieved universal primary education only to lose it when costs became unsustainable and quality fell, gives a graphic illustration of the problem. Setting standards, which can be achieved and sustained across the country and across time would be much more feasible if donors worked in support of Government expenditure programmes, respecting agreed national standards, and giving the best possible indication of their future financing intentions.

ix. The unpredictability and unreliability of donor flows has serious consequences not only at sector level, but is also a problem for macro-economic management. Donor flows can be highly uncertain as to their timing for purely bureaucratic reasons. Conditions have also proliferated at all levels from the project to macro economic and Governance issues. Managers at all levels can find that the financial resources on which they depend can be interrupted because of the failure to meet conditions at a higher or lower level over which they have no direct control.

x. Donor behaviour can undermine consultation, legitimacy and accountability to local stakeholders, through over-ambitious time schedules and inflexible donor policy positions. Pressures on donors to commit and to disburse, and pressures on the time of donor staff to plan missions to fit their own convenience rather than the speed of Government decision-making or the annual budget cycle, leave too little time and too little flexibility to accommodate unpredictable processes of consensus building.

xi. The pressure on donor professional staff to ensure that the proposals they bring forward conform to the current consensus on 'good practice' within their agency limits the realistic scope for financing Government proposals, which differ significantly from the current template. Even the words of Government policy documents such as the Policy Framework Papers agreed with the World Bank and the IMF are still routinely drafted in Washington. At lower levels, the ubiquitous logical framework, regarded by donors as a key tool for participation, in practice requires participants to master arcane theology before they can participate, and requires high level linguistic skills in English. The process risks either being stage-managed towards a product acceptable to the donor, or risks producing a confused mess, of little value in defining the project objectives and approach. The imposition of one particular tool is itself an example of a directive and non-participatory approach.

xii. More familiar distortions follow from tying of aid to home country procurement of goods and services. This can lead to higher costs, the proliferation of inappropriate equipment types, or (via tied technical assistance) the importation of advice based on inappropriate first world solutions to third world problems.

3. In summary, the behaviour of aid donors can fragment and subvert policy and budget processes, preventing Government acquiring capacity to develop and implement locally owned strategies.

Reforming the Process

4. The recent literature on aid effectiveness suggests that aid only works where the policy environment is conducive, but that conditionality has no observable positive impact on the policy

environment. The policy implication most usually drawn is to be more selective in deciding which countries to help, giving less emphasis to ex ante conditions, and more to assessing the track record and commitment of partner countries.

5. The process towards which a number of countries are struggling to evolve is one in which Government and donor funds are jointly allocated through a process of dialogue in which Government, donors, and other stakeholders are involved. This needs to take place at both national and sector level. At national level, a medium term budget framework (MTBF) is prepared to set out what Government wishes to achieve, what it will cost, and how it proposes to finance it from both domestic and foreign sources. This is discussed and broadly agreed with donors at appropriate points in the budget cycle. Sector programmes are nested within the MTBF, with a similar process at sector level, and with iteration from sector discussions to the overall budget discussion. Tanzania and Uganda are both in the second budget year in which donors have been involved in dialogue on the MTBF as part of the budget cycle. The process is not perfect, but progress is being made in increasing the proportion of donor funds captured in the budget presentation, and in improving the discipline on line ministries to prepare realistic budgets.

6. When this approach was introduced for the first time in Uganda, in 1998, the Government presented a high case scenario, showing how increased donor commitments would be used for spending on the poverty action plan. The Government succeeded in securing higher on-budget commitments from donors with which to implement the higher case scenario, and were also able to persuade the IMF to relax fiscal targets in order to allow higher budget receipts to be spent. The existence of a process for discussing issues of budget prioritisation and performance has survived the difficult security and defence problems, which Uganda has faced, and has probably been helpful to ensuring understanding of the issues.

7. It has proved difficult to fully include donor flows within the MTBF, but it is essential to do so. For as long as donors are outside the process, the hope of supplementary donor funding will encourage line ministries to delay the necessary hard decisions to fit their ambitions to their resources, contributing to a lack of prioritisation, with all activities under-funded.

8. Budget planning also needs to be supported by a process for improving budget management and accountability, linked to reform of the civil service, and to providing adequate incentives to public employees. Developing capacity in budget management is a time consuming process, but a forward step is to articulate an improvement strategy, and seek sufficient support to implement it. This also should be reviewed and rolled forward annually in consultation with stakeholders.

9. Problems need to be tackled at the level where they occur. Some issues require dialogue at the level of the political leadership and of the central economic ministries:- the revenue effort the country should be expected to make, the allocation of Government and donor resources between sectors and between types of spending (investment/recurrent, wage/non-wage), public sector pay policy, the extent of decentralisation of decision-making, and the basic systems and capacity for financial control and accountability. These central-level processes will only be fully effective if complemented by actions at sector level to develop the details of policies and programmes, and the capacity to implement them. Dialogue and support is needed at both levels.

10. It is important to be realistic about the speed at which capacity and trust can be established. In the case of Ghana health, the health sector programme was able to build on the results of nearly a decade of capacity building efforts in both planning and financial management at district to national level. This does not mean that sector programmes must always be preceded by such long preparation, but it is important to see the

sector programme as a process, not a blueprint. The most important requirements are a consensus on priorities and on policies, a transparent dialogue between Finance, the Line Ministry and the donor partners, and a willingness by at least a core of donors to take the risk of placing some of their funding through Government systems. This can increase over time as careful monitoring enables trust and confidence to be expanded, while the inevitable teething problems are solved.

11. It is important to ensure that the budget process responds to the needs of the population, especially the poor. The overall policy framework and the broad allocation of resources needs to be centrally decided, but efficient and equitable patterns of spending require budget processes which respond to locally perceived needs, and which are accountable to the communities intended to benefit. As a minimum, the collection of information from actual and potential users of services can check the validity of assumptions made as to spending priorities. There is a strong case for going beyond this, to move decision making closer to those who will benefit. This needs to go beyond the local Government level, where controls and accountability are sometimes even weaker than at central level. Uganda has therefore gone further, and appears to be having some success with moving towards block grants directly to schools, with resources controlled by locally elected parent committees. There is an important role for donors in supporting monitoring of outcomes and resource use, and in encouraging a stronger voice for intended beneficiaries, backed by access to the information to enable those managing funds to be held to account.

12. The increased stress on working in partnership with Government implies obligations on both sides of the partnership. However, Governments in receipt of concessional funds lack sanctions to hold donors to their commitments. It would also be a backwards step if donors held back information on their financing intentions for fear of contracting a commitment which would be difficult to break. It is more useful to recipients to have a best

estimate of future spending levels than to plan only on the basis of firm commitments. Nevertheless, where a formal commitment has been entered into, donors should be expected to honour it, and there may be a role for peer pressure from other donors who are also financing the programme. There is also a strong case for those donors who are able to do so, to sign up for longer-term commitments to provide support for sector programmes. This is no different in principle from the firm project commitments which many donors have traditionally entered into: there is no reason why commitments to provide budgetary support, or to help fund an agreed sector programme should be any less firm. Increased predictability of the amount and timing of donor support should be a major goal if 'partnership' is to be made meaningful.

13. On the Government side, the policies and programme described in the sector programme planning documents should also be regarded as a firm commitment, entered into between the Government and the funding partners, and subject to an agreed process of consultation for modifying it and rolling it forward to the next financial year. The policies and expenditure plans of a democratic Government can not be set in stone by a five-year agreement with the donor community, nor should they be. However, it is reasonable to establish an agreed policy direction and set of spending priorities, and agreed procedures for discussing new policy and programme developments, which impinge on the objectives of the sector programme. It is important to define the process by which disagreements will be discussed, and the sanctions, which may be triggered. There is a subtle distinction between this approach and the style of conditionality, which is used, in structural adjustment. For sector programmes, the conditions will consist of agreeing to undertake such measures as are necessary to achieve the objectives of the sector expenditure programme, and to refrain from actions, which are inconsistent with achieving those objectives. They are closer to the traditional approach to project level conditions, than to the approach of structural adjustment where the role of the aid was to purchase policy reforms which Government might not

otherwise have undertaken.

14. The approach to the aid relationship which is described here is mainly appropriate in highly aid dependant countries. Where Government is able to provide adequately for the recurrent budget, while also financing significant capital spending from domestic resources, an intrusive role for donors in the budget process would be inappropriate and it may make sense to confine donor flows to financing projects within the capital budget. This traditional approach can avoid the worst of the distortions described previously, provided Government retains control over the size of the investment programme, and of the selection of projects (though possibly appraising them jointly with donors). This model can work where policies are sound and there is a strong planning and budget process which keeps a balance between capital and recurrent funds, and where donor flows are modest, and do not excessively absorb Government attention. Examples might include the approach taken in much of South Asia. Within Africa, Botswana perhaps comes closest to this model.

Code of Good Donor Practice

15. This discussion suggests some principles for adoption by the donor community:-

i. Respect Government leadership in defining national and sectoral policies, through a locally managed process of consensus building.

ii. Ensure that donor funded technical assistance is driven by Government priorities, reports to Government managers, focuses on facilitation and capacity building, and supports priority public sector functions rather than individual donor projects or programmes.

iii. Conduct aid negotiations with the central budget authorities. Where a MTBF has been defined, donors should ensure it is fully financed before considering other proposals. Where no MTBF exists, or there is no financing gap, donors should ensure that Ministry of Finance are content that financing proposals fit within their budget priorities, and that counterpart and recurrent cost implications can be absorbed. Wherever possible, donors should make firm longer-term commitments.

iv. Ensure that donor support is consistent with Government policies, and is nationally replicable and sustainable given likely future resources. This does not rule out donor involvement in pilot programmes to test alternatives to current policies, but does impose a duty on donors to ensure that pilots are based on service standards which are nationally affordable.

v. Provide Government with full and timely information on donor intentions and actual delivery, including a full breakdown of budgeted and actual spending, covering direct donor expenditure including TC in addition to funds disbursed to the Government.

vi. Work with the existing Government structures and systems, helping to reform them where possible. Avoid creating competing structures or systems. Work with Government and other donors towards a situation where capacity and confidence is sufficient for all donors to rely on Government's own procedures for planning, appraisal., implementation, disbursement, accounting, monitoring, audit and evaluation.

vii. Where Government priorities are shared and management is reasonable, minimise earmarking, providing general budget support to ease the management burden in responding to local needs.

viii. Work collaboratively with other stakeholders, with joint decision-making as far as possible, but with a clear process for resolving disagreements or failure of either side to implement what has been agreed.

ix. Government regulations on remuneration and allowances should be strictly observed.