Economic Commission for Africa

African Union

African Plenary on National Strategies for Poverty Reduction and Implementation of the Millennium Development Goals

March 26-28, 2006
Cairo, Egypt

The Emerging Aid Architecture, PRSs and the MDGs

Economic Commission for Africa

African Union

The Emerging Aid Architecture, PRSs and the MDGs

By

Robert Liebenthal, Consultant
Lusaka, Zambia

And

Samuel Wangwe, Policy Advisor
President's Office
Public Service Management
P.O. Box 2483
Dar Es Salaam, United Republic of Tanzania

Background Paper prepared for the "African Plenary on National Strategies for Poverty Reduction and the Achievement of the Millennium Development Goals".

March 26-28, 2006
Cairo, Egypt

Revised March 2006

Contents

Acronyms

ADB	African Development Bank
APRM	African Peer Review Mechanism
AU	African Union
CfA	Commission for Africa
CFA	Communauté Financière Africaine
CSO	Civil Society Organization
DAC	Development Assistance Committee
ECA	Economic Commission for Africa
HIPC	Highly Indebted Poor Country Initiative
IDA	International Development Association
IFF	International Financing Facility
MDG	Millennium Development Goal
MTEF	Medium-Term Expenditure Framework
NEPAD	New Partnership for Africa's Development
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
PAF	Performance Assessment Framework
PRGF	Poverty Reduction Growth Facility
PRS	Poverty Reduction Strategy
PRSP	Poverty Reduction Strategy Paper
PEAP	Poverty Eradication Action Plan
PER	Public Expenditure Review
SPA	Strategic Partnership with Africa
SSA	Sub-Saharan Africa
SWAP	Sector-wide Approach
UNMP	United Nations Millennium Project

1. Introduction

At the aggregate macro-economic level, investment, even in the depressed state of most African economies, comes mainly from domestic savings. Foreign investment and remittances are also important, but, as various recent reports[1] have argued, are unlikely to be commensurate with official aid for some time to come. At the level of government budgets, all African countries (except Mozambique) still raise the majority of their funds domestically through taxation or other domestic financing.

But aid is important and likely to become more so, mainly because the *incremental* requirements to meet poverty reduction targets are unlikely to come from elsewhere. Thus the Commission for Africa (CfA) estimated that from 2006-2010, given absorptive capacity constraints, additional public expenditures to the tune of $37.5 billion per year are required for low-income Africa. Of this amount at most $12.5 billion would come from domestic resources, leaving $25 billion, or two-thirds, to come from aid.[2] The UN Millennium Project (UNMP) recommended a similar scaling up, though it did not estimate Africa's needs separately. Were such increases in aid to materialize, several African countries would be depending on aid for more than 50 per cent of their national budgets.

Indeed, the G8 Summit in Gleneagles promised a quantum leap in levels of aid to Africa from about $12 billion in 2004 to $25 billion per year by 2010. The G8 Summit also agreed to cancel all outstanding debts of eligible Highly Indebted Poor Countries (HIPC) to the IMF, IDA and African Development Fund.

The Summit appears to have been the culmination of a process initiated at the Millennium Summit in September 1999, which endorsed the Millennium Development Goals (MDGs), and started a process of global aid reform, which is still unfolding. The landmark event in this process was the Financing for Development Summit at Monterrey, Mexico in 2002, at which donor nations pledged to increase aid to 0.7 per cent of their GNP. The Kananaskis Summit of the G8 in June 2002 endorsed NEPAD and agreed on a G8 Action Plan to support it. Three high-level meetings (Rome 2003, Marrakesh 2004, Paris 2005) addressed comprehensively the issues surrounding aid effectiveness and results for development. In addition, the fourteenth International Development Association (IDA) replenishment saw an increase in IDA resources of approximately 25 per cent, with about 30 per cent in the form of grants. The countries facing the toughest debt problems – most of them in sub-Saharan Africa – will get all of their support in the form of grants, while less debt-burdened countries will receive IDA's highly concessional long-term loans. Taken together with the recommendations of the UNMP and the CfA, as well as the outcome of the G8 Summit these developments suggest there is seriousness about aid reform, with a particular focus on the needs of Africa.

This background paper sets out the salient facts about aid to Africa and reviews the estimates of aid requirements and availabilities. The main focus is on the quality of aid and aid effectiveness in the context of a possible large increase in aid to Africa. It discusses aid modalities, with a particular focus on budget support and mutual accountability. It concludes with a discussion of aid policies for African countries. The vantage point is that of the aid partner or recipient, and the territory is how African governments, individually and collectively, can best improve aid effectiveness, influence aid delivery and build aid into development plans and poverty reduction strategies that will improve their chances of achieving the MDGs.

1 UN Millennium Project (UNMP) and the Commission for Africa Report (CfA).

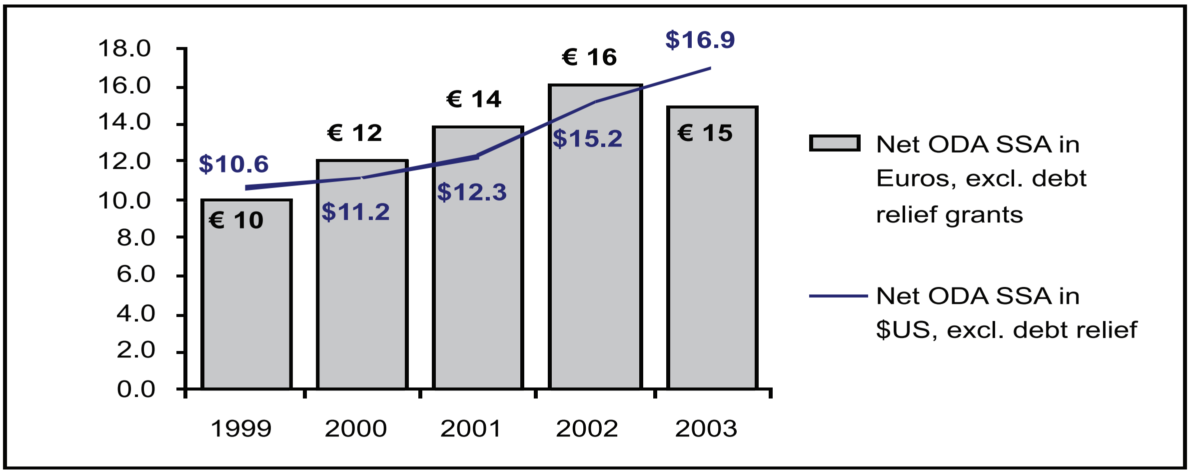
2 CfA page 308.

2. Aid to Africa – a quantitative overview

2.1 *Aid Volumes*

Total Official Development Assistance (ODA) to Africa fell by 26 percentage points in real terms from 1993 to 1999[3], and then rose again by 49 per cent from 1999 to 2003. For sub-Saharan Africa (SSA), the decline in 1993-99 was slightly lower, and the rise from 1999-2003 slightly higher whilst ODA to North Africa has declined steadily. The main factors accounting for the decline were the reduction in Balance of Payment (BoP) support following the CFA Franc devaluation and in aid to so-called 'failed states'. The rise in 1999-2003, on the other hand, was driven mainly by debt relief and emergency aid initiatives. In 2003, debt relief of $5.0 billion to the Democratic Republic of Congo and Cameroon accounted for 21 per cent of ODA. Without these two one-off transfers, ODA would have declined in that year. Furthermore, as Figure 1 below shows[4], if debt relief grants are excluded, and if ODA is measured in Euros rather than US dollars, ODA to sub-Saharan Africa actually declined in 2003.

Figure 1: Net ODA transfers to sub-Saharan Africa in US Dollars and Euros, 1999-2003



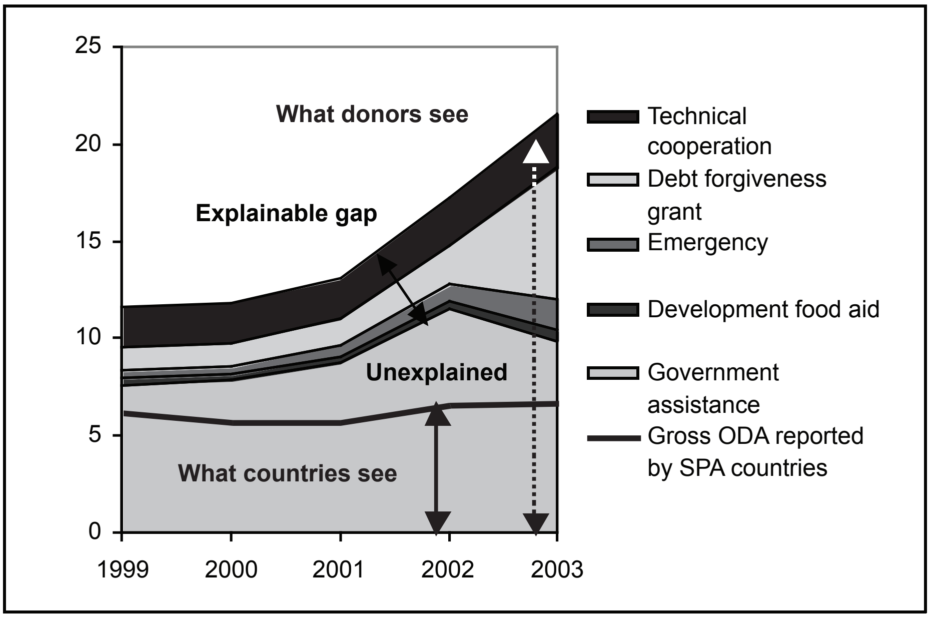
Africa's share of total ODA declined from 50 to 36 per cent from the early 1990s to 1999, but recovered to 46 per cent in 2003. In terms of the uses of aid, there has been a major shift away from production and infrastructure to the social sectors and governance. In particular, aid to agriculture has fallen sharply. Emergency aid has risen significantly, but programme assistance (BoP or budget support) has declined and gradually been replaced by debt relief.

Hence, aid under the control of African governments – as opposed to that driven by donors – is only one third of total ODA reported by OECD/DAC. For 2003, ODA reported by African countries in their BoP data was $6.7 billion, compared with OECD-reported net flows of $22 billion and excluding Nigeria (see Figure 2 below). If debt forgiveness grants are added, "discretionary" resources in the hands of African governments, were $13.4 billion, a substantial increase, but still only two-thirds of the amount OECD reports. Most of the difference is explained by the existence of technical cooperation grants, emergency assistance and development food aid. However, a large unexplained residual for 2003 of $3.2 billion remains. A similar discrepancy arises over quick-disbursing assistance (BoP or budget support), which was $2.8 billion (African view) or $2.1 billion (donor view) in 2003, but projected at $3.1 billion (African view) or $4.4 billion (donor view) for 2005. As will be developed later in this paper, the unpredictability of budget support detracts significantly from its usefulness, since it forces governments into an excessively cautious approach to expenditure management.

3 2002 prices and exchange rates. Source: OECD/DAC: Draft Annex to Chapter III of the Mutual Review.

4 Source: Donovan, Paula: Stepping up Support for Human Development, Growth and Poverty Reduction in Sub-Saharan Africa, Presentation to SPA Plenary, Johannesburg, South Africa, January 19, 2005.

Figure 2: The ODA Gap as seen by donors and African Aid Recipients, 1999-2003



These ambiguous trends should be compared and contrasted to the improvements in African countries' performance, as measured by the World Bank's Country Policies and Institutions Assessments (CPIA) ratings. Out of 45 countries, the benchmarking average CPIA has improved from 2.5 (on a scale of 1-5, 5 being high) in 1997 to 3.2 in 2003. Five countries performed in the upper tier (greater than 3.5) in 1997; this had grown to 15 countries by 2003, while in lower tier (less than 3.0), the number of countries fell from 25 to 16. While ODA is rewarding performance more than it did in days of the Cold War, the recent pattern has been for previously poorly performing countries to be rewarded (appropriately) with more aid, especially debt relief, and for the consistently good performers to retain their shares. Meanwhile, the middle group of countries is, consequently, being squeezed.

2.2 AID REQUIREMENTS

The most comprehensive estimates of global and continental aid requirements are found in the UNMP and the CfA. The discussion in this section therefore focuses on the conclusions of these two reports. A joint IMF/World Bank paper for the Development Committee, completed more than one year before the CfA and UNMP and based on an aggregation of country studies (and not confined to Africa), concluded that at least $30 billion annually in additional aid was needed to meet the MDGs[5]. As will be seen, both UNMP and CfA project larger requirements.

UNMP estimates that, for all low-income countries, incremental investment needs required to finance the MDGs will be $104 billion in 2006, from a base of $149 billion in 2002, rising to $380 billion in 2015. It expects domestic resource mobilization to meet $43 billion of the incremental requirement in 2006 (i.e. 41 per cent), rising to $257 billion (68 per cent) by 2015, leaving a gap to be filled by ODA of $61 billion (59 per cent) in 2006, rising to $123 billion (32 per cent) in 2015. It counts only $12 billion of ODA for low-income countries in 2002 as supporting achievement of the MDGs. Therefore aid must *increase by a factor of six*, to $73 billion by 2006.

UNMP does not separate Africa's requirements from those of other low-income countries around the world. However, it estimates that the requirements are fairly consistent among all low-income countries, at $70-80 per capita in 2006, rising to $120-160 by 2015. It projects an increase in domestic resource mobilization of four per cent of GDP across low-income countries through 2015, but the GDP growth assumption is not reported.

The CfA projections are more easily adapted to the purposes of this paper, first because they relate directly to low-income African needs, (though excluding middle-income countries), and second because they quantify expenditure needs in addition, or complementary, to the MDGs. Thus 27 per cent of the costs of the CfA's recommendations would be for growth, infrastructure and trade, while a further 18 per cent would be for governance, peace and security, mitigation of shocks and contingencies.

Taking into account absorptive capacity constraints, the CfA estimates that an additional $37.5 billion per year in public expenditures will be required through 2010. Of this, $12.5 billion (i.e. one third) would come from additional domestic resource mobilization, and $25 billion from aid – effectively double the 2003 ODA level. The Report further proposed that requirements

5 Development Committee: Supporting Sound Policies with Adequate and Appropriate Financing, September 13, 2003.

beyond 2010 would be based on assessment of the experience in 2006-2010. It takes a more cautious view of the prospects for additional domestic resource mobilization in Africa than does UNMP, assuming five per cent per annum real growth and the maintenance of a tax ratio to GDP of 15.7 per cent. It argues that tax ratios in most of low-income Africa are already high relative to other regions, and need to be kept at this level to encourage private sector growth. If growth were to rise to 7 per cent, domestic revenue would rise by $18.6 billion, which would almost eliminate the need for additional aid! Apart from showing how sensitive these projections are to small changes in assumptions, both reports are very close in their estimates of aid requirements; and both are clear that individual country and regional plans and programmes must be developed to clarify requirements and incorporate them into specific plans[6].

Both reports also address the broad issues of aid effectiveness from a recipient country vantage point[7], notably macroeconomic concerns about possible "Dutch Disease" effects, and the two main components of "absorptive capacity": overall governance, especially public finance and expenditure management, and availability and motivation of skilled and trained manpower to deliver services and manage the key institutions. They both conclude that Dutch Disease effects are possible, especially if much incremental aid goes to sectors with low use of non-tradables like education and health. The UNMP report[8] argues that these effects can be managed by raising supply-side productivity through investments in human capital, agriculture and infrastructure, and by ensuring that aid supports rigorous, monitored investment programmes. It concedes that there is likely to be real exchange rate appreciation, but does not address the consequences for exports.

The CfA takes a different approach.[9] It argues that export competitiveness must be maintained and improved, and that the level and composition of large aid increases could pose a threat. The solution it proposes is to ensure that aid is also used to reduce costs for exporters, by improvements in transport and port infrastructure, and maintain the progress in removing trade barriers. In common with UNMP, CfA also argues that, while Dutch Disease effects are a possibility, simulations of country experience suggest that they are unlikely to be important.

On absorptive capacity concerns, both reports argue that aid must be premised on improving governance; that governance in the most relevant areas has improved in many countries; and that aid should initially be scaled up in the best performing countries. Service delivery constraints can, they argue, be addressed over time, the main issues being how long it will take, and how radical the measures aimed at relieving such constraints should be. For example, CfA argues that, for education and health, which depend substantially on attracting and retaining skilled manpower, aid commitments should be made for a long enough period (10-15 years) so that remuneration levels and conditions of service are conducive to retention, even if financed by aid.

2.3 AID AVAILABILITY

At the global level, the UNMP and the CfA have made a formidable case for a quantum leap in levels of aid to Africa. It should be noted that both reports take as given *existing* plans to increase aid by those donors that have done so, and are looking for increases well above those levels. Thus the CfA's recommendation to double aid to Africa by 2010 from 2003 levels (i.*e.* from $23.8 billion to $50 billion), is composed of an increase based on existing projections of about $10 billion, leaving a gap of $15 billion[10]. Some indication of possible responses is provided by the IDA 14 negotiations, which resulted in an increase of about 25 per cent, the largest increase for 20 years, but far short of the doubling envisaged. Likewise, the leaders of the Gleneagles G8 meeting in July 2005 committed to debt relief of up to 100 per cent to eligible low-income countries and mandated the IMF to review ways of financing it, whilst also promising a doubling of aid to Africa by the year 2010.

However, even if pledges are made, it will be important for African countries to take a realistic view of likely flows. The track record of the donor community in living up to pledges has been mixed. In addition – as alluded to earlier – there is a large gap between official ODA flows and those amounts that countries can count on and manage. Donor-controlled aid flows, like technical assistance, may serve useful purposes, but are often difficult to fit into a planning framework, whether at macro or sector level. Then there is the issue of the length of time for which donor commitments can realistically be made, and therefore the extent to which countries should lock themselves into expenditures which will be hard to reverse such as salary increases for civil servants.

6 The CfA is especially concerned to ensure that provision is made for regional cooperation requirements, both in terms of physical investments in infrastructure, trade facilitation, higher education and HIV/AIDS, and in terms of ensuring that resources, mainly grants, can flow to regional economic organizations.

7 These are addressed comprehensively in the other background papers for the SGPRS.

8 UNMP page 247.

9 CfA page 317.

10 CfA page 310. This estimate seems consistent with the Development Committee study referred to earlier.

3. Aid Quality

The quality of aid is a function of both donor and recipient country policies and practices. On the government side, the main determinants of aid effectiveness are addressed in the other background paper: i.e. the quality of poverty and growth strategies, the degree of political commitment, and the rate at which capacity and implementation issues are addressed. In addition, as will be discussed below, governments need to put in place more effective aid policies.

There are four broad aid modalities: projects, technical assistance, sector support and budget support. The OECD/DAC classification also reports emergency aid, which is not addressed in this paper, development food aid and debt relief grants. For the current purposes, development food aid, which is a small share of the total, can contribute to projects, sector or budget support, while debt relief has most of the same characteristics as budget support.

Broadly speaking, there are ten issues or concerns generally raised regarding the quality of aid:

a. ***Aid is misallocated.*** Especially during the Cold War, aid followed political allegiances, rather than performance. This has changed markedly over the past 15 years or so. For example, many more donors use allocation criteria which reflect country performance on economic efficiency, governance, poverty reduction etc. But those criteria are not yet transparent.

b. ***Loans vs. grants.*** As more countries complete the HIPC process, a growing concern is the contracting of large amounts of new debt, especially on non-concessional terms. This concern has been heightened by growing evidence that some of the analysis on which post-HIPC debt sustainability was based was overly-optimistic. The issue is likely to be most serious for infrastructure projects or programmes, where loans are likely to be part of a tied-aid package. The issue is country-specific, since countries which have strong debt management and good prospects should not be limited from achieving higher investment levels.

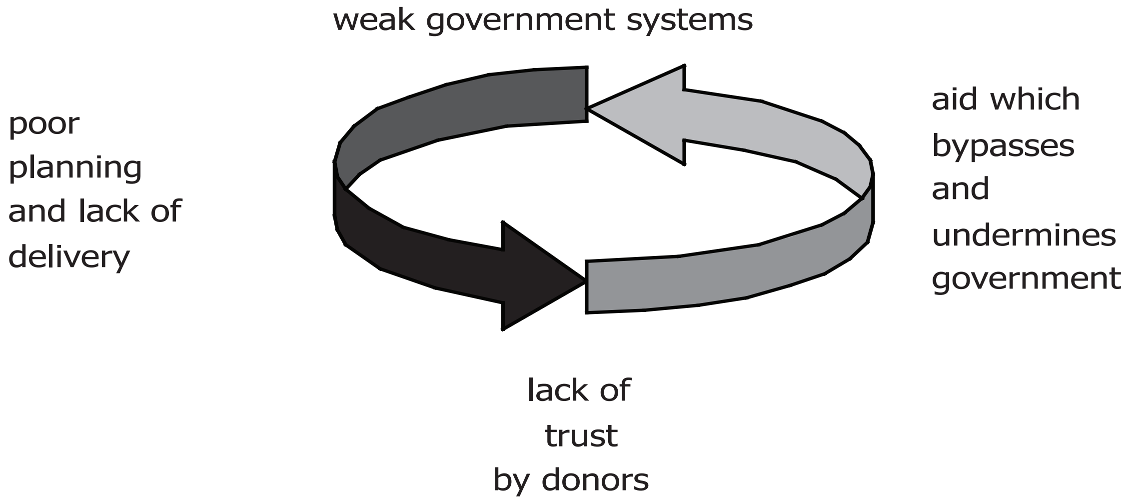
c. ***Aid is a burden on limited national capacities.*** The OECD/DAC reports that, in 2003, Tanzania received 230 donor missions, (over and above ongoing meetings with local donor offices), Ethiopia 200, Senegal 150, Mozambique 140 and Zambia 120. In the area of public finance management alone – an area where donors have made an effort to avoid duplication – there were on average between 4 and 5 diagnostic missions per year in African countries.

d. ***Aid is unpredictable.*** Most donors use a multi-year planning framework or agreement, but annual budgets often diverge from plans, even if they are the subject of pledges or agreements. In the case of budget support, where donors disburse directly to a recipient country's budget, the Strategic Partnership with Africa (SPA), an informal association of donors and African partners that works to improve the quality and increase the quantity of assistance to Africa, reports that 81 per cent of 2003 commitments in Africa were disbursed that year. This is an improvement over previous years, but still not sufficient to provide a solid basis for fiscal planning by recipient governments.

e. ***Much bilateral aid is still tied,*** undermining its efficiency, increasing its cost and channelling much of its benefits back to the donor countries.

f. ***Aid can undermine government systems and accountability.*** The diagram depicted below, from the 2004 report of the SPA Budget Support Working Group, illustrates the basic problem. Weak government systems (planning, budgeting, procurement, financial management etc) lead to poor results in terms of service delivery which in turn lead donors to develop parallel systems of their own – Project Implementation Units; separate procurement, accounting, audit, monitoring and evaluation systems; lack of information on aid disbursements, especially relating to projects; and donor resources which do not pass through the exchequer. Looked at from the point of view of an individual project or sector programme, this may make sense, but the overall result is a plethora of different systems which in turn make government systems even weaker and more fragmented. Some donors, of course, have their own requirements and tend to prefer separate systems, even if government systems are strong. However necessary this might appear in terms of the donor's own accountability systems, such practices undermine national capacities and processes and ultimately threaten sustainability.

The vicious circle of bad aid



g. ***Aid is often not aligned with national priorities and programmes,*** most notably the PRSP. Projects and programmes may be financed outside the PRS framework, and governments may feel they have little choice but to accept them. Project finance, which remains the dominant mode of aid delivery, is particularly susceptible to this issue.

h. ***Different donor conditionalities can conflict, tend to be excessively numerous and arise from donor prescriptions rather than national consensus.*** Some ex-ante conditionality is inevitable, since donors can justify the amount of aid or its early disbursement if they receive promises of action to address policy issues that impede development. And conditionality can be helpful. In the 2004 budget support survey by SPA, the African governments surveyed gave a positive grade to donor conditionalities, presumably because they helped reinforce discipline. However, conditionalities which do not derive from national programmes and are not subject to wide consultation on the basis of solid evidence-based analysis risk weak implementation and conflict.

i. ***Administrative procedures can be onerous, inefficient and lead to delays.*** The SPA Budget Support Working Group reports that, even for budget support, administrative problems on the donor side accounted for 29 per cent of disbursement delays. The DFI report on aid effectiveness[11] breaks down procedures into conditions precedent, disbursement methods and procedures, procurement procedures and donor coordination, and uses these to rate donor performance on a country basis.

j. ***Global funds can cut across national systems for resource allocation, priority setting and aid administration.*** For example, in Uganda, the Global Funds for HIV/AIDS, Malaria and Tuberculosis initially sought to operate outside the Poverty Eradication Action Plan (PEAP) and Medium-Term Expenditure Framework (MTEF) rather than negotiating adjustments to permit higher expenditures.

Technical assistance as an aid modality remains particularly problematic, since recruitment tends to be tied to funding sources, and is driven by project level needs rather than by a capacity building programme at national or sectoral level. Subsidized external technical expertise can undercut an "infant industry" of national providers.

These concerns have been widely recognized, and are the subject of an ongoing aid reform process, which started with the Monterrey Conference on Financing Development in 2002, and continued through high-level meetings in Rome 2003, Marrakesh 2004 and Paris 2005. In the Rome Declaration in 2003 and again in Paris in February 2005, donors committed themselves to:

- Ensure development assistance is delivered according to partner country priorities, including PRSs;
- Amend donor policies, procedures and practices to facilitate harmonization by reducing donor missions, reviews, and reporting, streamlining conditionalities, simplifying and harmonizing documentation;
- Implement good practice standards and disseminate them within donor organizations (HQ and field);

11 Johnson, Martin and Bargawi, Development Finance International: "The Effectiveness of Aid to Africa since the HIPC Initiative: Issues, Evidence and Possible Areas for Action", Background paper prepared for the CfA, page iii.

- Intensify delegated cooperation (the practice of one donor handling another donor's interests in a country or sector);
- Develop within-organization incentives for harmonization;
- Support country capacity for analytical work;
- Support country-led efforts to streamline donor procedures and practices;
- Provide budget, sector or balance of payments support;
- Harmonize global and regional programmes, (e.g. the Global Fund for HIV/AIDS, Malaria and TB).

Some progress is being made. Across the continent, a "mutual review" conducted in 2004 jointly by OECD/DAC and the ECA concluded that six African countries had formal donor harmonization action plans, and discussions were underway in ten more. Sector programmes are becoming more numerous and are maturing. And there was close coordination of budget support in about 10 more countries. However, the review also concluded that projects are still the dominant aid delivery modality; capacity development is still piecemeal and supply-driven by donors; that coordination is generally donor-driven; that coordination of missions, delegated cooperation, shared analysis and information have a long way to go; and that changes are needed in local donor motivation and leadership. The Paris High Level Forum on Harmonization in February 2005 proposed some specific benchmarks to monitor progress in all these areas, though agreement has yet to be reached on a number of them.

4 Budget Support

Budget support is aid that is transferred directly to the partner country's national treasury.[12] Generally, there are no restrictions on the end-use of the funds, or their sectoral allocation at the level of individual donors. Budget support is distinguished from sector support, in that the latter is disbursed to or for a particular sector or group of sectors, either through the national budget, or through a donor-controlled mechanism such as a basket fund. Thus World Bank and ADB adjustment credits (now development policy credits) count effectively as budget support. World Bank Poverty Reduction Support Credits (PRSCs) are a special kind of budget support, in that it is specifically programmed to match the country's budget/MTEF cycle.

Budget support has been growing in popularity as an aid modality, though as noted earlier, programme support (in which budget support is included by OECD/DAC) still absorbs a smaller share of total aid to Africa than in the early 1990s. As of March 2005 eight countries had active donor budget support groups, (Benin, Burkina Faso, Ethiopia, Ghana, Mozambique, Rwanda, Tanzania and Uganda), and more such groups were being formed in Madagascar, Malawi and Zambia. In Mozambique and Tanzania, 15 donors provide budget support, including the World Bank, thereby demonstrating that almost all sizeable donors have the potential to provide such support. At this point, only the United States, among the large donors, does not provide budget support.

When viewed from the standpoint of African countries' poverty reduction and growth plans, budget support has distinct advantages:

- It provides greater flexibility, and permits an easier allocation of resources in accordance with the national PRS, and with the expenditure requirements arising from the MDGs;
- It focuses donor attention, including analysis and dialogue, on issues of budgetary management and policy, including expenditure allocations, rather than on specific projects. It recognizes that resources are fungible and encourages that resource use be addressed directly and in a consolidated manner;
- It promotes national ownership by encouraging the use and strengthening of national planning, budgeting and accountability processes, rather than fragmented donor-driven processes;
- As a consequence, it facilitates a more strategic policy dialogue with government and, potentially, with national stakeholders;
- It provides "built-in" harmonization – i.e. since only national processes are being used, there are no separate donor requirements. Thus it can potentially reduce transaction costs, though it has yet to fulfil this potential;
- By permitting the use of donor resources to substitute for tax revenue or reduce government recourse to the banking system, it can reduce crowding out of the private sector and/or inflationary pressure;
- It can improve the predictability of aid generally, though there are risks (see below).

These advantages have still to be fully realized in practice. However, they have already made a major contribution to donor harmonization. A recent study in Tanzania, for instance, has found that budget support has had immediate effects in the five areas postulated in the framework[13]:

- It has dramatically increased the proportion of external funds subject to the national budget process, and at the same time increased ownership of the development process.
- It has helped to focus dialogue on the strategic issues of economic management, and in the process made some significant contributions to the design of policy.
- It has helped to focus technical assistance and capacity building on core public policy and public expenditure processes, contributing to the process of institutional renewal which the Ministry of Finance has undergone over 1996 to the present.
- It has made a major contribution to the alignment process.

At the same time the conditions for successful budget support are exacting. The main issue for donors will generally be the quality of the whole public finance and expenditure management system. In fact donors need to be able to persuade their legislatures and other relevant authorizing bodies that the systems in place are as good as those they customarily use for aid, or that they at

12 See the OECD/DAC Best Practice Note (op. cit) for a clear statement of the "state of the art" from a donor's perspective.

13 Joint Evaluation of General Budget Support: Tanzania 1995-2004. Final Report. Report to the Government of Tanzania and the PRBS Development Partners. November 2004.

least meet a minimum standard, and that those systems are in the process of being improved and strengthened. While this is typically a donor concern, African countries are also giving governance concerns higher priority; and if economic governance is to be strengthened, the fragmentation of accountability systems among several donors and projects needs to be reduced.

The second set of issues for donors concerns the quality of national poverty reduction and growth programmes, including sectoral and subnational programmes; and the effectiveness of public expenditures in meeting the goals of development, above all the MDGs. This, as set out in the background paper on capacity, involves not only the quality of the PRSP, but its operationalization through action plans and budgets, and the arrangements for monitoring and evaluating results. In addition, donors will want to give weight to a country's track record and implementation performance, in addition to the quality of its plans and intentions. This poses a dilemma for situations where, for example, there is a change of government, or where a government has strong intentions of breaking with the past. This set of issues is also of equal or greater concern to African governments, whose political survival increasingly depends on better economic and social performance.

Budget support typically involves three main components: (a) the PRS or growth strategy or plan, which sets out the broad programme for reducing poverty and attaining the MDGs; (b) a process for diagnosing and strengthening public finance and expenditure management, including accountability systems, procurement and expenditure reviews; (c) a performance framework, which sets out expected results, to be monitored and assessed. It is critical for successful budget support that the donors come together around all three components, and that they accept and encourage government leadership in all of them. Generally, the issues relating to budget support in a particular country are addressed in a Memorandum of Understanding between the government and participating donors.

4.1 POVERTY AND GROWTH STRATEGY

It is commonly recognized among donors that budget support should be "aligned" with the national PRS. "Alignment" in this context is taken to mean that (a) conditionalities are derived exclusively from the PRS or national plan; (b) any additional conditionalities should have both a strong justification and be subject to the same process and scrutiny in the country as was the PRS; and (c) that the key decision points on budget support, like commitment, tranche release or disbursement, are well coordinated with the budget cycle. Studies suggest that there has been some improvement in this over time[14]. The main difficulty here is that PRSs, as broad strategy documents, are not the kind of action plan or detailed programme that implementation ministries need, or that donors are used to and prefer. Stakeholders, as well as donors, need to see that the PRS is reflected in budgets and work programmes, and that implementation issues are being effectively addressed. For this reason, it is essential that PRSs as well as annual plans, budgets and MTEFs go through an effective consultation process, and receive some kind of blessing from parliament. This is taken up below in the discussion of the performance framework.

4.2 PUBLIC FINANCE MANAGEMENT

The two main issues here are to bring donor support to bear on improving and strengthening systems, through technical advice, computerization etc; and to minimize the extent to which donors demand special, tailor-made reports and fiduciary practices. The overall aim is to use donor attention on public finance processes to ensure that they reach high standards, which are also expected by the electorate and legislators. This is also an area where conditionality can be useful, by reinforcing national stakeholder and popular demands for systems that prevent corruption, waste and mismanagement. But conditionality will be counterproductive if it concentrates on parallel reporting required by individual donors, or if it fails to address key issues and constraints in the national fiduciary and accountability systems.

Through the DAC's Public Expenditure and Financial Accountability (PEFA) Secretariat, working together with the IMF and World Bank, considerable attention has been given to harmonizing donor practices through an integrated assessment. However, the latest report of the SPA Budget Support Working Group notes that there was an average of 4.8 diagnostic exercises in 2003, with as many as 11 in Niger and 8 in Ghana. Governments can put pressure on donors to limit the number and frequency of these exercises by establishing and implementing tough programmes to improve their public expenditure management, including strong anti-corruption programmes which are having demonstrable results; and by insisting on good international expertise from the IMF, World Bank and bilateral donors who are known to be applying best practices.

Inevitably some donors will require their own reporting and fiduciary systems. Here the main aim should be to avoid such systems conflicting with or undermining national systems. In addition, donors should be asked to pay the full costs of such systems, especially personnel brought in to supervise or collect data. In extreme cases, if the requirements are too intrusive and counterproductive, as can be the case with some small donors, consideration should be given to declining the offered assistance.

14 See, especially, the reports of the SPA Budget Support Working Group.

4.3 PERFORMANCE ASSESSMENT FRAMEWORKS

These frameworks have become the main instrument for donor conditionality. There are several issues here:

a. ***Policy dialogue.*** Donor organizations have considerable expertise and experience to offer on issues of development policy and strategy. The importance of good policy cannot be overemphasized. Budget support has the potential to "unpack" policy advice and dialogue with donors from resource flows and allow them to be addressed on their merits. This challenges donors to strengthen evidence-based analytical work and policy formulation within a national context. At the same time it challenges governments to enhance the quality of their own analytical and policy work, to permit a more constructive and open engagement with all stakeholders, including donors. In part this is a capacity issue.[15] An important special case is the macro-fiscal framework, for which an IMF staff-monitored programme or a Poverty Reduction Growth Facility (PRGF) is always a condition. While this should not change ex-post, there should be more willingness to consider different macro scenarios ex-ante, in particular to permit higher public expenditure levels provided these do not induce excessive inflation rates and are consistent with the PRS programme.

b. ***Results vs. policies.*** "Old style" adjustment credits of the World Bank, the ADB and other donors, used a policy matrix, often with considerable detail, to monitor performance and decide disbursements. By contrast, the EU uses a results-based approach, in which there is an agreement to monitor specific outcomes or targets to be attained. Donors are generally shifting towards a results-based approach, but this is limited by the difficulties in finding monitorable outcome indicators, collecting data on them in a timely manner, and in agreeing on what indicators should satisfactorily measure progress. In practice, most PAFs seek to measure progress in both policies (i.e. inputs) and results.

c. ***Number of performance indicators.*** The best practice is to minimize the number of conditions. This is often done by some aggregation and simplification of indicators, built from a "bottom up" approach. But the process of deciding these is difficult and time-consuming, especially when the PAF seeks to be comprehensive and cover all or most of the sectors in which the PRS foresees actions. In Ethiopia, for example, it took almost one year to "boil down" more than 100 indicators to 20 or so. The difficulty is not necessarily on the donor side, especially in those cases where sector ministries have been implementing Sector-wide Approach (SWAP) or sectoral projects where their control of the funding and the performance expectations was exercised with less accountability to the finance ministry and the rest of the government. Sector ministries will try (correctly) to use the PAF to protect their allocations and programmes. In addition, the "boiling down" process inevitably brings in more room for judgment and discretion, and thus risks reducing predictability.

d. ***"All or nothing".*** The aim of harmonizing conditionalities and procedures is laudable, but carries some risks, most notably that all donors will adopt the same performance indicators or disbursement triggers, with the result that a large part, maybe all of budget support is jeopardized if a particular target is not met. To address this, the PAF should be seen as a coordinated framework, and different donors should be encouraged to "specialize" in particular sectors or issues. Another approach, being used by the EU, is fixed and variable tranches: the fixed tranche depending on basic macroeconomic conditions and a go/no-go signal from the IMF, the variable tranche providing for a graduated response depending on the extent to which indicators are achieved.

e. ***Predictability.*** The SPA Budget Support Working Group reports that 81 per cent of 2003 budget support commitments were disbursed in 2003, and another 10 per cent in 2004. However, there is still room for improvement. Best practice suggests that donors should disburse funds as early as possible in the fiscal year, so that residual uncertainties are minimized. But, as noted above, there is a possible trade-off between predictability, based on clear and unambiguous performance indicators, and having a limited number of "aggregated" performance indicators, which leaves more room for discretion.

f. ***National processes.*** The PAF is "for donors", in that it is the *sine qua non* for budget support. However, if aid is to increase as much as the CfA and the UNMP suggest, and if budget support is the preferred modality, there is a growing danger that the dialogue with donors around the PAF becomes more important than, and substitutes for, the dialogue with national stakeholders and legislators. Unlike the budget and the MTEF, which are, by definition, national processes, the PAF is not – unless specific steps are taken to ensure that it forms part of national reporting procedures, integrated into the planning and budgeting cycle. There is every reason to expect that there would lead to substantial benefits: stakeholders and parliament should have a role in monitoring and will enrich the discussion of outcomes; donors will benefit from greater insights into what is working well and less well, and will gain reassurance from evidence of buy-in, even if at times there are disputes. The chances of realizing this convergence will be improved if national monitoring and evaluation systems are developed and used effectively vis-à-vis domestic constituencies as well as donors. The concern, in countries like Tanzania, where serious efforts have been made to strengthen monitoring within the budget cycle, is that processes become "heavy" and complex, with a large number of consultations. In addition, it imposes further discipline on donors to plan and undertake reviews and consultations at a time that fits with partner government budget cycles.

15 See also Johnson, Martin and Bargawi, Development Finance International, op. cit, page vi

Learning from other countries about how to plan and implement effective consultation around a monitoring document should be a key part of every country's budget support programme.

g. ***Political conditionality.*** Political conditionality is problematic, not only because it is intrusive, but also because it is hard to define in advance. On the other hand, political conditionality is more likely to arise in the case of budget support, which is likely to be perceived as open to leverage by important constituencies in donor countries. Donors are encouraged to minimize the use of political conditionality in the context of budget support, but rather to be treated as part of a broader political dialogue. However, African governments can also reduce the risks associated with political conditionality by (a) strengthening national accountability processes, especially vis-à-vis parliament, political parties and pressure groups, so that the informal feedback mechanisms from these groups to donor countries are supportive; (b) strengthening the African Peer Review Mechanism (APRM) and other continent-level good governance initiatives to enhance international confidence.

h. ***Seats at the Table.*** In countries like Mozambique and Tanzania, where budget support has been occurring for several years, the number of donors involved in the process is as many as 15. Not only is this unwieldy, but it runs the danger that donors providing relatively small amounts can exercise substantial leverage. The use of delegated cooperation for budget support is one possible method here. In addition, there are suggestions that there be thresholds for donor participation in budget support, based either on absolute amounts that they provide, or on shares of their total programme.

i. ***Multi-year commitments.*** With the shift to Medium-Term Expenditure Frameworks, generally covering three years, it is essential to have at least indicative amounts, with as much firmness as possible, to cover the same three-year period. And, as indicated earlier, for some sectors which are highly dependent on recurrent costs, the commitment needs to be as long as 10 years. Some donors are able to do this, others not. The best policy for governments is to work towards as much consistency in programme implementation as possible, so as to strengthen donor willingness to make longer-term commitments.

5 Mutual Accountability

The Paris Declaration on Aid Effectiveness (February 2005) endorses mutual accountability and transparency in the use of development resources as a major priority. Partner countries commit to strengthen the role of parliaments in development strategies and/or budgets; and to reinforce participatory approaches in the formulation and monitoring of national development strategies. Donors commit to providing timely and comprehensive information on aid flows; and both commit to jointly assessing mutual progress in implementing agreed commitments on aid effectiveness.

Few countries have as yet developed strong mutual accountability frameworks with donors. Tanzania and Mozambique are two that have made considerable progress. In Tanzania, aid effectiveness progress is assessed by an Independent Monitoring Group (IMG), which reports annually. This particular device arose out of Tanzania's experience in the early 1990s, when government/donor relations were poor. The precursor of the IMG was introduced in a bid to introduce better communications and trust, around an action plan developed by an independent third party. The lesson is that different models are appropriate for different environments and historical circumstances, and that donors and governments need to be put under pressure to perform better through working back from concrete development outcomes.

At the continental level, a promising start has been made to rating donor performance against specific criteria. The SPA Budget Support Working Group report asked governments to rate donors both collectively an individually according to their existing practices and to rank donor performance on specific issues, notably the use of reports generated by government and aligning missions with the national calendar. The HIPC Capacity Building Programme (CBP)[16] also developed a methodology for HIPC governments to assess the overall quality of aid they receive using 23 evaluation criteria. On the basis of this methodology, specific scores for individual donors and recommendations for improvement have been derived. In addition, OECD/DAC peer reviews of donors have been carried for several years, but not yet within a mutual accountability framework.

16 See Johnson, Martin and Bargawi, Development Finance International, op. cit, page iii and 13-15

6 Aid policy

External financing policies, if they existed, have typically only addressed borrowing policies. As has been suggested above, there is a need for policies at the country level to address issues of aid effectiveness and quality more comprehensively. At this point, few African countries have an explicit aid policy or strategy, which addresses aid dependence and exit strategy; the coherence among policy objectives; the preference for particular aid instruments; the preferred approach to capacity; the number of donors and their comparative advantage. It is important for African governments to develop such policies and subject them to a process of dialogue both within their countries and with donors.

The higher levels of aid dependence likely to result if UNMP and CfA recommendations are implemented might appear to limit the scope for country aid policies, since African governments would appear to have less bargaining power. However, greater aid dependence makes aid policies more, not less, essential, since an explicit exit strategy is even more pressing, even if it is long-term; and because donors typically react constructively to government leadership, provided the quality of the analysis on which it is based is convincing and that there is an opportunity for discussion.

An issue in aid policy will be the role of the Legislature. Some countries require all external loans to have legislative approval. Others find this too restrictive. In view of the questions surrounding debt sustainability in most countries, the lack of transparency involved in tied aid, and the need for alignment with national plans, parliamentary approval should be the rule rather than the exception.

7 Recommendations

a. The CfA recommendation for an "annual discussion…between the Development Ministers of the OECD countries and African Finance Ministers, along with representatives of civil society and international organizations…[to] consider aid allocation criteria and make suggestions for better aid distribution" should be supported. In addition, such a discussion should also include planning ministers and address aid effectiveness issues, possibly through an expansion in the scope and mandate of the SPA.

b. Consideration should be given to having regular consultations among African Finance Ministers on issues of continental aid policy, supported by a small secretariat, either with UNECA, the AU or NEPAD.

c. While welcoming and encouraging increases in aid to Africa, Finance and Planning Ministries should continue to take a realistic view of likely flows to their countries, until there is an agreement on mechanisms, such as the International Financing Facility (IFF) or the application of HIPC-type "threshold conditionality"[17] to aid flows, that would introduce more predictability at the global and regional level.[18]

d. African countries should continue to strengthen national planning, budgeting and financial systems, with a special focus on poverty reduction and fiduciary issues, as the basis for insisting on progressively stronger alignment of donor assistance with national plans and processes. As a corollary, governments should encourage donors and others, including stakeholders and outside peer reviewers, to evaluate their progress in strengthening national systems, as part of the APRM or otherwise.

e. Government should continue pressing to increase the share of aid in the form of budget and sector support.

f. Governments should establish mutual accountability frameworks at the national level, drawing on the growing body of international good practice, and mandated by the Rome-Paris harmonization process.

g. Governments should develop explicit aid policies and consider embodying selected aspects in legislation.

17 See OECD/DAC Best Practice Note on Budget Support. The HIPC system, by providing irrevocable debt relief once certain conditions are met, effectively produces 100 per cent predictability for those resources. Similar mechanisms could, in principle, be put in place for aid flows, or part of them.

18 Knowledge sharing should be encouraged on countries' practices. For example, Uganda discounts budget support pledges by donors by a factor (currently 35 per cent) fixed at the average level by which disbursements have fallen short of commitments over the previous five years. Ethiopia has a similar procedure.