

*Neue Wege in der Entwicklungszusammenarbeit: Budgethilfe als effektiver Beitrag and die Millenniums-Entwicklungsziele?*  
*Nouvelles voies pour la collaboration au développement : L'aide budgétaire – une contribution efficace aux Objectifs du Millénaire ?*  
*New Paths for Development Cooperation: Budget Support as an Efficient Contribution to the Millennium Development Goals?*

### ***Risks of general budget support: a tale of experience***

*Richard Gerster, Gerster Consulting, Switzerland<sup>1</sup>*

It is Friday evening. Representatives of the Government of Mozambique have just informed the assembled donors that they wish to cancel one paragraph in the negotiated „Memorandum of Understanding“ (MoU) for general budget support. The paragraph describes that in case of disagreements, the donors first negotiate among themselves and – if possible – only then approach the government with an agreed position. Some donors argue that they can not make changes to the document which was otherwise ready to be signed being already approved by their headquarters. However these offices are already closed and the ceremonial signing is planned for Monday which is why a last minute change is said to be out of question. On Saturday evening the World Bank invites to a social event. Among the invited is also Mozambique's Prime Minister who confirms in informal talks that the signing would not take place on Monday unless the paragraph in question was cut. On Sunday afternoon all donors assemble for a crisis meeting. One hour later the Prime Minister is informed that the change is accepted. On Monday, April 5, 2004, the ceremonial signing of the Memorandum, which provides the framework for the future joint budget support of all donors, takes place.

#### **Key messages**

Stakeholders from the North and South, as well as those within a partner country, who participate in budget support have **different perceptions** of the associated risks;

Budget support is based on **preconditions** of good governance and the fight against poverty, whose potential violation presents a risk;

The **fiduciary risk** arising when the state is spending of tax payers' money includes corruption and weaknesses in the system and is not unique to budget support;

Usually several ways claim to lead to success. Policy pluralism leads to **policy risks**, which are carried by the partner country;

The appearance of financially strong donors threatens to compete with local capacities and sources of financing if this **risk of displacement** is not addressed actively;

Budget support also offers **chances** to address the roots of these risks through a packet of financing, dialogue, service agreements and training.

<sup>1</sup> This text represents the author's personal view.

## Differing perspectives between North and South ...

This episode illustrates two points: first of all, the government possesses negotiation leeway, if it acts in a decided manner. Secondly, it perceives negotiating with a united group of donors instead of dealing with each country individually as a major risk of budget support. In case of disagreement, a „**front of donors**“ increases the risk for a country to be confronted with a large gap in the financing of its state budget, should the donors discontinue their payments in a coordinated manner. Contrary to the government, the donors judged this to be a minor risk.

A mutual „ganging up“ of donors is not the only risk. Research done by the International Monetary Fund (IMF) has shown that dramatically **erratic fluctuations** apply to development aid in general, not only to budget support specifically. It fluctuates between 6 and 40 times more than fiscal income<sup>2</sup>. In the context of budget support, a lot of effort is dedicated to predictability and some progress has been achieved<sup>3</sup>. However, especially changes in political power on the donors' side remain a source of uncertainty. In 2003, after a middle-right government came into power in the Netherlands, agreed disbursements for budget support remained suspended over several months. Procuring financial means through the financial market turned out to be very expensive for the African country and the IMF criticised the donor's unpredictability with harsh words. It is not a coincidence that short- and medium-term predictability of budget support stands at the top of the priority lists of partner countries in order to decrease the risk of delayed or missing payments.

## ... and within the partner country

The view of the ministry of finance in a partner country is often not congruent with the way **sectoral ministries** view budget support. When discussing the transformation of sector to general budget support in Ghana, the main worry of the ministry of health was to continue the comprehensive dialogue between the government and the donors and to not replace the health experts with a panel of economists. However, specific ministries often do not react in such a constructive manner when confronted with the challenge of general budget support. They rather prefer the previous situation of dealing directly with the donors, because they judge the risk of not obtaining the money in this situation to be smaller than when they have to deal with their own ministry of finance. Comfort on short notice or counter-productivity on the long-term – the donors have to consider carefully what they support.

General budget support aims at strengthening the state in its core functions and usually deals with the central state as partner. However, there are other relevant stakeholders beyond the ministry of finance and other central ministries if the Millennium Development Goals are to be achieved. **Regional and local governments, the private sector and civil society** hold prominent places in the vision of a functioning state. Parliament and civil society have their own priorities and have to demand accountability from the public hand for their activities. General budget support contains the risk of losing sight of decentralised levels, especially parliament and civil society as instances of shaping and controlling processes. This can and needs to be counteracted concertedly by the government itself as well as by the donors. The members of parliament in Mozambique, for

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<sup>2</sup> Bulir/Hamann 2005, 7.

<sup>3</sup> SPA 2005.

example, noticed that they have been better informed by the government, not least of all thanks to budget support. Transparency and legitimacy are important framework conditions in order to give the state at the service of its population a chance.

If donors think about risks, they usually discuss entirely different topics: the explicit or implicit preconditions of cooperation, namely good governance and targeted poverty reduction, and in addition fiduciary risk which includes corruption. It threatens the basic element of cooperation: mutual trust. Not only reformers but also profiteers are a part of each government. Trust is good – as is control.

### **No budget support without „good governance“**

Democracy, human rights and rule of law in the wider sense are either implicit or explicit preconditions of budget support. The promotion of good governance is one of the strategic aims of Swiss development cooperation. SECO, as the centre of competence of economic cooperation, views the economic use of public finances and the mobilisation of the partner's own resources as important elements of governance. In the case of the Kyrgyz Republic, SECO and other donors, especially the World Bank, planned to use budget support simultaneously as instrument for the strengthening of decentralisation. Considering its centralist tradition the government had promoted far reaching innovations with windows of opportunity for local autonomy for some time. But the partly chaotic and certainly very fragile political conditions after the revolution of 2005 lead to the suspension of further clarifications with respect to budget support until further notice. An independent review has shown that political insecurity also led to serious weaknesses in the management of the public finances, in spite of initial progress. Budget support does not presuppose a development Eldorado in order to be fruitful. But – depending on the local context – certain conditions are required in order for reforms at the service of poverty reduction to stand a real(istic) chance.

### **Which way to poverty reduction?**

A second precondition of budget support – besides good governance – is the alignment to poverty reduction. As a rule the poverty reduction strategy is seen to be a basis. However its implementation into practice, especially through the budget, can demand difficult priorities.

In Ghana **subsidies for oil** burdened the state budget with around 250 million dollars in 2004 – a lot of money that could also have been invested in the health or another sector. Starting in February 2005 the government increased the price for petrol by 50% in several steps to reach world market level. This resulted in a number of demonstrations as large segments of the population felt the increased prices of bus tickets and other transport costs. However the wallets of the middle and upper classes felt the burden most. One litre of petrol costs now, in the middle of 2006, a little over 1.20 CHF (1 US\$). The liberalisation of petrol imports, which put an end to oil subsidies, was a key element in the agreement between Ghana, the IMF, the World Bank and bilateral donors like Switzerland. Tax payers want poor people to benefit from development cooperation. In view of „value for money“ it makes sense to ensure that budget aid is not spent on petrol subsidies but rather used for the promotion of agriculture or the educational sector while mitigating unwanted social effects in a more targeted way.

## Corruption – a perennial issue

**Mozambique** features on place 97 out of 159 on the corruption index of Transparency International (2005). The new president Armando Guebuza agitated for the fight against corruption in his campaign. Policemen touch up their salary with virtual fines or teachers pocket tips and goods from parents. Functionaries' salaries of several hundred francs are ridiculously low. In the summer of 2005 the government published a report about the country's corruption. By doing so it redeemed a promise to its international development partners, including Switzerland. However, the average family views corruption only as number eight of their daily problems. More important are unemployment, living costs, lack of clean drinking water, insufficient food, missing streets and the prevalence of crime. Interestingly the police leads the ranking of dishonest institutions. Highest priority for drastic reforms in the public sector is legitimate.

Risks exist not only in every day small-scale corruption, which affects both budget support and project aid equally. More important issues arise when government priorities shift and an approved budget and final accounts diverge. This can happen due to abuse or weaknesses of the system. When in 2001 two large banks in Mozambique became insolvent, the government decided to save the banks with a financial injection of over 100 million francs – equal to the help that the Swiss government provided for the rebirth of SWISS. The **banking crisis** was a result of corrupt intrigues at the expense of the small savers. It was overcast by the murder of a journalist who was working on uncovering of the background. Switzerland and other donor countries only agreed to the rescue mission after hard negotiations. In return, Mozambique promised to shape the supervision of banking according to international standards and undertake further reforms in the financial sector.

## Underestimated policy risks

There is global consensus about the Millennium Development Goals. The ways to the goals, however, are manifold. Depending on the historic and political context of a country priorities are set differently. In politics **pluralism** rules, not universal recipes. This is the basis for policy risk – economic policy can be misleading or bring about unexpected side effects. Memories of the debate on structural adjustment programmes in the 1980s and 1990s and their social damage surface. Besides the corruption debate policy risks narrow the benefit of reforms for the poor („value for money“). The first generation of poverty reduction strategies neglected the productive private sector and prioritised – under international pressure – public services in education and health. Was this the best for poverty reduction? Be as it may, the consequences are mainly borne by the partner countries' governments and population – not by the IMF/World Bank or bilateral donors. Also in the context of budget support, which is based on partnership and without imposed conditions („conditionalities“), the influence of donors on a country's economic policies remains substantial, because the unbalanced power lingers in the background. Rules and practice of the government's accountability are key.

As soon as we imagine a similar situation in **Switzerland** the significance of policy pluralism and risk are evident: A dozen African countries send their representatives to Switzerland. Previously the Federal Council and Parliament discarded a comprehensive report about the progress of reforms in the past years. The African experts and the Swiss authorities discuss various issues in detail, for example the reform of the federal finances,

weaknesses in the supervision of banking, the rapidly increasing costs of the health sector, the expansion of the rail and road networks, the financial perspective of the social insurances and the asylum and migration policy. The foreign guests hold the opinion that fiscal evasion needs to be punished and the banking secrecy regulation should be adapted to international standards. This issue is highly controversial in our political landscape – as are many other issues. This fictitious example illustrates how essential the local anchorage („ownership“) is for chosen strategies and how much caution is needed for external interventions.

Among the seven partner countries which have been closely examined by the independent OECD/DAC-Evaluation of general budget support, **Vietnam** holds a special role. The donors support the government's policy and reform programme, which deviates in relevant aspects from economic orthodoxy, for example privatisation. Political measures are hardly negotiable as they are in other countries. But since the government can show significant progress in poverty reduction<sup>4</sup>, since Vietnam is an interesting market and its dependency on external aid is limited<sup>5</sup>, it works out even. In the „diffuse“ context of many African countries the aim is to find a precarious balance between influence and understanding through dialogue. The partner government needs to hold the responsibility for the chosen policy not only formally but also in reality, as the risks of success and failure lie in the partner country anyway.

### **Hidden risks of displacement**

The donor side usually has relatively large human resources at its disposal in order to analyse factual issues, elaborate proposals and carry on negotiations. Whatever the reasoning may be, it can become dangerous if external interventions start competing with **local capacities**. This risk of crowding out exists for example vis-à-vis the administration: In 2004 the donors in Burkina Faso made a proposal for a new MoU which the government declined, because they saw the lead in the cooperation to be their own task. A risk of displacement also exists vis-à-vis civil society: The donors find themselves in a privileged situation in the budget support dialogue with the governments. It is important to take precautions in order for parliament and civil society not to remain outside the door. Conversely budget support can be used to increase their influence on political decisions. An important possibility is for example the promotion of local think tanks in order to propose alternatives in economic policy.

Also, foreign aid always includes the risk of displacing **local sources of financing**. That would be disastrous, because taxes are more than a fiscal issue. Tax payers are asking return services and accountability from the state about its activities. At the same time, revenue is a precondition for sustainable public finances. The OECD/DAC-Evaluation which has just been concluded has found no indication that budget support has crowded out tax income in partner countries. However, the claims of budget support should go further: In view of an exit strategy the mobilisation of local state revenue needs to be promoted actively. That is why in some countries an increase in tax revenue is part of the agreement between the government and the donors.

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<sup>4</sup> Between 1993 and 2002 the percentage of people living below the poverty line fell from 53% to 29%.

<sup>5</sup> Public aid amounts to around 5% of the gross national income.

## **Where there are risks, there are chances**

Taking risks is inherent to development cooperation. With general budget support most kinds of risks hardly need to be weighed higher than in the traditional bilateral cooperation, where for example „**fungibility**“ of money generally is not an issue. As a citizen I would prefer the taxes I am paying in Switzerland to be spent on social activities rather than armament. We know that such a demand is illusory – so why do we believe in the additionality of traditional project aid, if for example Switzerland systematically finances medication for the state health service? However, the risk in budget support is generally more transparent, nourished by the comparatively intimate knowledge of the bureaucracy. Growing insight into the mechanics of policy and administration does not necessarily mean that the risks themselves grow as well.

Budget support offers chances to address the **roots** of risks with a tailored packet of measures such as financing, policy dialogue, service agreements and training. A Swedish expert of the situation took positive stock: “In five years, Mozambique has changed from an extreme venture to a high risk country.” This realistic but never the less carefully positive assessment can be traced back to the government’s efforts to use the chances of budget support, such as:

- The increase of tax revenue is fixed in the criteria framework (performance assessment framework, PAF) for measuring the partnership’s progress of reform;
- Strengthening parliament and civil society creates impulses for improved accountability of the government;
- The promotion of the ministry of finance’s research capacities for the analysis and possibilities in economic policy reduces the policy risk;
- The improvement in public finances, procurement and public servants addresses the causes of corruption.

**Leverage** is typical for programme or budget support. Increased salaries, transparent benefits, less public servants but instead a productive administration – these are goals of often long overdue administrative reforms. However, reforms such as reducing the number of employees, also create losers and resistance. Even if long dead officials figure on the payroll – the payment of the salary always takes place in this world. Budget support is not only about ensuring that aid money is not spent on other purposes than intended. Its chance lies much more in increasing care in the administration of public finances and through that a reduction of the risk of corruption on the medium-term.

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