A case for budget support

By John Blunt

This is a guest post by John Blunt, a Public Sector Management and Procurement Expert. This article looks at the case for budget support, and how to assess and manage risks associated with its use.

Budget support has become an increasingly important foreign aid instrument. It has received growing attention by bilateral donors and international financial institutions in the context of a partnership-based approach to development assistance. Yet the concept of budget support itself is still emerging and subject to different interpretations. It has also raised skepticism among observers who question the impact, fiduciary soundness and incentives of budget support.

What is budget support?

Budget support is a way of implementing development aid, which involves giving financial aid to the treasuries of the recipient countries. This aid increases the resources available to the recipient country to implement its own budget according to its own procedures. So a key characteristic of budget support is that it goes directly to the partner government and is integrated into their own systems of appropriation, procurement and accounts, and is not connected to specific projects. The aid is usually given subject to certain conditions of eligibility and implementation.

Budget support has several advantages over traditional projects

Budget support lowers transaction costs by providing funds directly recipient country's poverty reduction programs strategies to reduce poverty (or their sectoral strategies).

It reduces fragmentation and decision making, which leads to more efficient allocation of the resources. Through budget support, donors can promote good governance by supporting the partner country's institutions.

Budget support also provides resources and incentives for improvement in the country's own capacity, the effectiveness of its systems, its organisation and its institutions. Budget support gives donors a right of scrutiny and dialogue/assessment in respect of the recipient country's whole budget (if only through its budgetisation). Donors thus have an overall view of revenue as well as planned expenditure. Donors providing budget support can therefore give their opinion on the budget and the various stages in the domestic budgetary procedure. The influence Donors may have (directly or indirectly) on a country's budgetary choices calls for an overall vision of all the country's political priorities and thus provides a framework for broader dialogue encompassing other forms of aid.

Budget support is the most suitable form of development aid for fulfilling commitments under the Paris Declaration on aid effectiveness. The Paris Declaration provides for five areas of action: appropriation by the beneficiary country, alignment on the priorities and procedures of the beneficiary country, harmonisation of donor action, results-oriented management and mutual accountability.

However it also exposes the donor to different risks

There are also number of issues and concerns related to budget support:

- Macroeconomic risks – unpredictability of disbursement, risks in common conditionality, undermining revenue effort, absorptive capacity and aid dependency.
- Fiduciary risks – risks that public resources are not used for the intended purpose; are not properly accounted for; and/or do not provide value for money i.e. corruption risks.
- Political risks.

The critical issue is how these risks are *assessed* and *managed*.

Many factors can affect an individual donor's decisions to use a country's public finance management system besides expected benefits: the assessed quality of the system; the donor's legal framework, historic practices, or tolerance for risks; the recipient country's own preferences; and related intangibles such as the perception of corruption or poor governance.

Donors base their proposals and decisions on eligibility for budget support on an assessment of the initial situation and the prospects for improvement in the situation. Such analysis means that the Donor is selective in its interventions. This dynamic interpretation of the conditions for eligibility, in particular the condition concerning public finance management and procurement, may increase the short-term risk. But the selective approach that this entails, based on rigorous analysis and the will of the recipient country to reform, and backed up by capacity-building, makes it possible to reduce and manage this risk.

This requires rigorous assessment combined with close cooperation with recipient countries and other development partners.

There are a range of tools for doing this.

A key first step is for each donor to define the criteria under which it will assess and manage the risk associated with the use of budget support as an implementation mechanism and the tools to be used to assess potential recipient countries against the criteria.

For example, the European Commission's eligibility criteria for countries to receive budget support are:

- a well-defined national or sectoral policy and strategy;
- a stability-oriented macroeconomic policy; and
- a credible and relevant programme to improve public finance management and

PEFA. Assessment of developing country public finance management systems is normally through an Integrated Fiduciary Assessment, which usually involves Public Expenditure and Financial Accountability (PEFA) assessment which evaluates the strengths and weaknesses of the public finance management system and provides a performance benchmark to measure progress with public finance management reforms and evaluate if a reorientation of the ongoing PFM effort is needed. The PEFA methodology provides a framework for developing country governments and other stakeholders to assess the public finance management system in a country. The PEFA indicators are a set of 28 high level performance indicators that measure strengths and weaknesses of a government's public finance management system.

CPA. The use of World Bank Country Procurement Assessments (CPA) and other assessments can be used to examine public procurement system performance. A CPA is an intensive, comprehensive assessment and diagnostic tool offering analysis of a particular country's public procurement regime. Specifically, the CPA identifies existing risks and vulnerabilities of the regime and assists the developing country in ultimately strengthening the institutional, legal, and policy framework underpinning its procurement regime. The CPA report is typically a joint effort between the WB and its client country. These assessments are also conducted as the public procurement system in a particular country changes or undergoes reform.

MAPS. The OECD Methodology for Assessment of National Procurement Systems (MAPS) provides a common tool which developing countries and donors can use to assess the quality and effectiveness of national procurement systems. The assessment uses 12 indicators which can become a key element of, and will improve, the existing CPA process.

A recent review of the websites of the World Bank and other donors notes that few PEFA, CPA and/or MAPS assessments have been undertaken in East Asia, Papua New Guinea and Pacific Island countries in the past three years.

When is budget support most appropriate?

The emerging consensus among donors is that budget support provides a more effective approach to development assistance for countries that have a good track record and a reasonably sound policy and institutional framework, including transparent budget and adequate financial management and procurement systems.

In countries with weak public financial management and procurement systems, additional safeguard measures may need to accompany budget support. These could be in a form of conditionality, earmarking or additional accountability requirements. Support may be linked to technical assistance to overcome specific weaknesses in public financial management and procurement systems.

Budget support may not be appropriate if there are no adequate public financial management and procurement systems in place, the country has not developed a viable poverty reduction strategy, or donors cannot find sufficient common ground with a recipient country's general policies and budget priorities. In this case, financial support at a sector level could be considered through a sector wide approach or stand-alone projects. This approach may help build appropriate implementation arrangements that can establish a track record of reform and a growing degree of confidence to facilitate an eventual transition to general budget support.

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