

**Chairman's Summary**  
**Budget Support and budget certification - is it the way forward?**  
**(8<sup>th</sup> July 2011 2pm-5pm)**

**Chair: Alison Evans, Director of ODI**

**Speakers:**

**Professor Paul Collier, Director, Centre for the Study of African Economies, Oxford University**

**Mick Foster, Senior Research Associate, ODI,**

**Marcus Manuel, Senior Research Fellow and Director of the Budget Strengthening Initiative, ODI**

This purpose of this meeting was to discuss the use of a budget certification system in the context of giving aid through Budget Support. It is the fourth in a series of discussions analysing the experience of giving aid through Budget Support over the last ten years; lessons learnt and the challenges Budget Support faces in the current aid environment.

***Speaker's presentations***

The meeting was chaired by Alison Evans and opened with presentations from **Paul Collier**. **Mick Foster** and **Marcus Manuel** were discussants.

**Paul Collier** presented his ideas on establishing a budget certification system for Budget Support operations formally for the first time. He first spoke about the problem with the current approach to aid; why a certification system was necessary; how it would work in practice and what it would mean for the various actors in the aid relationship.

In Collier's opinion the use of aid has been long on policy objectives but short on the use of instruments to deliver those objectives. The instrument donors have typically used in the aid relationship is to vary the volume of aid, i.e. how much aid to give. This is flawed under the Tinbergen-rule according to which donors need as many aid *instruments* as objectives. As a result, donor policy has lurched between different objectives in a 'fidgety way, re-prioritising whatever donors think is being neglected'.

Aid objectives can be streamlined, but in Collier's perspective not beyond two key ones; that of *need* and *effectiveness*. To achieve these objectives requires the use of at least two different instruments: the volume of aid and the modality through which it is provided. Crudely, how much aid to give can be linked to the objective of aid and how effective this aid is can be linked to the modality that is used. The key variable that should define which modality is used should be the recipient country's governance conditions. At present, donors vary the volume of aid with the quality of governance conditions but in Collier's opinion this needs to be rethought.

In his opinion in countries with better governance conditions Budget Support is the best modality and the government the best agent as it has the best information on where funds should go and is accountable to its people. In badly governed environments, however, 'life support' and not Budget Support is needed. These are environments where two fundamental conditions are not met. First, *the partner government does not have the right intentions*. To

assess whether governments are 'benign' and working for the benefit for their citizens is a political judgement which donors need to make as part of the aid relationship. Second, *the partner government does not have the right capacity*. In Collier's opinion we do not currently have an 'honest process' for assessing whether government systems are of the right standard. This requires an assessment not of the capacity of the political elite in government but the channels through which money needs to pass. Government may not have adequate capacity where public spending is 'leaky' and where the civil service is unable to deliver government intentions either because of incompetence or corruption.

His **proposal** is to have an **international certification system** which will certify countries as 'fit' or 'not fit' to receive Budget Support. An Independent Certifier (IC) will have to satisfy itself that the money passing through the budget process could not be misappropriated and the system is as robust as an OECD country system to be able to withstand different political pressures. If a country failed the certification process a notice would be served and there would be the potential for re-certification after three years. During the interim period the country would be allocated support to build its capacity. If the country failed again the donor would have to change the modality it was using although the volume of aid would remain constant.

Why would such a system be to the advantage of a *recipient country*? Certification can help empower domestic reformers to change their public financial management (PFM) systems and limit leakage. This leakage not only weakens the delivery of public services but the captured funds are used to purchase political patronage. From the point of view of *taxpayers in donor countries* certification can send a strong signal that there is a zero-tolerance to corruption within aid processes. *Donor agencies* will need to move away from the status quo and provide aid through other transitional arrangements if recipient countries do not pass the certification process. The *certifying body* will need additional diagnostic instruments than those already available and will need to sign-off on its assessment to be able to send strong signals regarding the state of domestic PFM systems.

In his presentation **Mick Foster** questioned whether certification was necessary and how it would work in practice. His contention was that aid especially the volumes promised under the Millennium Development Goals (MDGs) cannot be delivered as effectively through any other aid modality as Budget Support. He made the point that the term Budget Support actually refers to a spectrum of aid modalities that use government systems ranging from General Budget Support (GBS) to Sector Budget Support (SBS).

He agreed with Collier that the problem of weak PFM systems needs to be dealt with but in his opinion any aid modality that bypasses the government has serious short term and long term consequences. If necessary, donors could use additional mechanisms to help manage the risks associated with using specific country systems such as such as procurement audits, shortening fund flow, and community accountability advance and replenish systems, earmarking etc. He felt that Budget Support helped give donors an invitation to dialogue with recipient governments about weak PFM systems and their poverty reduction objectives. Furthermore, Budget Support operations are often instrumental in strengthening such systems.

Mick Foster also had questions around how a certification process would operate in practice. He made the point that any PFM system has a degree of non-compliance and 'leakage' including that of the UK. It was then difficult to establish what criterion a certification process would use and how rigid it would be. Related to this was the question of which institution could act as an IC. The assessments that the IMF currently perform like Report on Observance of Standards and Codes (ROSCs) and Public Expenditure and Financial Accountability (PEFAs) do not provide the necessary detail needed for certification. Procurement audits and Public Expenditure Tracking Surveys (PETs) would be required. Alternatively, if private accountancy firms are used then the reputational risk to these firms could make them set certification standards artificially high. Monitoring would also have to be constant since improvements in PFM systems was a 'process not a destination.'

**Marcus Manuel** made additional comments on the certification proposal. He strongly agreed with Paul Collier that the perceptions of taxpayers in donor countries had to be responded to and therefore the way Budget Support is currently managed has to be re-visited. He also agreed that improvements in PFM systems are necessary. Even though a lot of money is being spent to improve these systems, but analysis of PEFA scores suggest that across countries progress has been modest. For example among African HIPC countries while a quarter have shown an improvement; half have shown no significant change and a quarter have demonstrated a deterioration in their performance.

He could see two problems with using certification in practice. First, a time-inconsistency problem where donors may not be comfortable providing aid through Budget Support in the interim period between when a country is developing its capacity. Instead donors might insist that no budget support is given until the actions have been taken. He also felt that certification could become something of a 'holy grail', that the standards required to introduce Budget Support could be so high that they would be unattainable.

From his point of view an important step in the right direction would be to increase transparency in assessments of PFM systems by for instance publishing PEFA scores and through the Open Budget Index. Moreover, he considered that if recipient countries scored badly on different existing assessments then they would need to accept a greater level of intrusion from donors in how they manage their public finances. For instance there are a range of instruments, like the Afghanistan Reconstruction Trust Fund, that have been used and are currently in use by donors that are more intrusive (e.g. in terms of auditing) but provide donors with the additional assurance they need.

## ***Discussion***

The idea of a certification system for Budget Support operations generated a lot of discussion. The discussion focussed on four main areas.

### **Clarifying the proposal**

As this was the first time ideas on the certification process had been widely presented a lot of discussion focused on clarifying what everyone understood by the terms being made in the proposal to ensure shared meaning. Some participants made the point that weaknesses in public expenditure systems in developing countries were not in PFM systems but in the *compliance with* those systems. A certification process would need to measure compliance to the system and then, would need to set some acceptable threshold as even in OECD countries a hundred per cent compliance was not achievable. The compliance would be with the system and not the composition of spending or the policy choices that government made. Paul Collier was firm that certification was not about policy conditionality but about enforcing good standards of governance. It was noted that measuring compliance is not a straightforward task.

A lot of discussion was around the alternative modalities donors would have to use in countries which did not pass the certification process. An assumption made by Mick Foster and other participants was that when countries did not pass the certification test, donors would use project aid. Collier clarified that his suggestion was not that project aid should be used in countries not eligible for 'pure' Budget Support. This clarification reduced the differences in views about certification amongst participants. However, a point was made that although certification may not be intended to increase project aid, donors may in fact see projects as the obvious alternative to Budget Support.

### **Additionality of certification**

Another area of discussion was around whether certification was necessary in the context of other diagnostic instruments which analyse country systems such as PETs, Procurement audits, ROSC and in particular PEFAs. There was some discussion on the limited value of PEFAs as they were only published if the recipient government chose to do so, were published with a lag, and were not formally used to determine whether countries would receive Budget Support. For these, and other reasons PEFAs do not lead to better PFM performance. Certification then would be distinct from PEFAs as it would measure compliance with systems not just systems themselves. Its greatest value would be in sending a strong signal that a particular PFM system was not up to standard.

### **How certification would work in practice**

There were some questions on how certification would work in practice. There was a concern about *data scarcity*. Any process to measure compliance to a public expenditure system would require in-depth work and primary data that was difficult to obtain in developing countries. The *time-inconsistency problem* with certification was discussed again. Collier's suggestion is that countries that fail to certify should be given three years to improve their systems before Budget Support is suspended. However, participants felt that politicians in donor countries would find it difficult to provide Budget Support in the interim years between certification and re-certification. It would be difficult to explain to taxpayers in donor countries how country systems were being used to give aid when they had failed to certify. There was a largely held view amongst the participants that a pass/fail certifications system would not work and that a rating and ranking of some sort would be required.

### **Would certification achieve its objectives?**

A large part of the discussion focussed on whether certification would actually achieve its various objectives including that of better PFM systems. Certification could have an impact on incentives of line ministries to improve PFM systems. This is because line ministries traditionally often resist the introduction of Budget Support if it diverts aid coming directly to the sector to the general budget. If donors made the provision of Budget Support conditional on the performance of PFM systems line ministries could resist pressure from ministries of finance to improve their management of funds.

Others felt that if however the ultimate aim of aid is to improve domestic revenue (such that aid is no longer required) then *taxpayers in developing countries* needed to have sufficient trust in their own public expenditure systems. Certification could help make that transparent and also help transfer good practices across countries. An opposing point of view was that certification would not work as a signal for recipient societies as long as aid continued to flow from donors to government systems. The domestic audience did not care about the modality being used but saw any type of aid flowing between donors and governments as complicity.

Similarly many participants did not think that certification would improve the trust of taxpayers *in donor countries* in aid processes as they did not know or care about aid modality per se but that any aid was being given to a country that did not make the right spending choices (the favourite example used was that of purchasing a presidential jet). It was suggested that tax payers are more fundamentally concerned with the values and human rights issues in the recipient countries rather than whether aid was being used efficiently.

Participants also did not think that certification would help with the broader aims of Budget Support, specifically those related to *growth, poverty reduction and improving service delivery*. Certification would make donor choice discrete in an environment that was actually quite complex and such a focus may draw attention away from addressing the real bottlenecks that limit the achievement of such objectives. Similarly, dislodging the political capture of leaked funds is also a long term complex issue that could not be tackled by certification alone and might not be tackled in three year windows.

In the end certification may not work not because weaknesses in the process but because it would not be seen to be a *credible* process. As donors do not always live up to their promises, recipient countries may not improve their systems because they did not believe that donors would actual deliver aid even if they did pass the certification process. This was to do with a larger discussion on donor incentives and assumptions made about 'benign donors'.

The discussion **concluded** with some consensus amongst participations on several points:

- Budget Support was an effective aid modality and at its best was very good but had probably been used in contexts where it shouldn't have.
- PFM systems in developing countries need strengthening which needs to be acknowledged.
- More transparency and better communication required on ratings of country systems.
- A certification system could be one solution through which donors could clearly signal that public financial systems in those countries were not up to standard and that donors are not operating in a 'zone of discomfort' . However, there are several questions around how certification would work which remain unaddressed. As a start, the view was that certification could not be a pass/fail system but a rating system to reflect different types of PFM systems. When countries fail the certification system, the countries would need to accept a greater level of intrusion in their financial management systems as donors would require additional safeguards to help manage the risk of using government systems. Exactly what the alternative modalities would be requires much greater thought and the safeguards that would be required would have to be context dependent.