Mokoro Ltd

Putting Aid On Budget

A Study for

the Collaborative Africa Budget Reform Initiative (CABRI)

and

the Strategic Partnership with Africa (SPA)

SYNTHESIS REPORT

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THE AID ON BUDGET STUDY

The Collaborative Africa Budget Reform Initiative (CABRI) and the Strategic Partnership with Africa (SPA) commissioned study of "putting aid on budget" has the following outputs:

An ***Inception Report***, which defines the issues and research methodology.

Ten ***country studies from sub-Saharan Africa***. Of the ten country studies, ***Ghana, Mali, Mozambique, Rwanda*** and ***Uganda*** were studied in depth, and separate country reports are available. The experiences of Burkina Faso, Ethiopia, Kenya, South Africa and Tanzania were also reviewed and summary information is included in the Synthesis Report annexes. Findings from all ten countries are included in the Synthesis Report.

A ***Literature Review***, which (a) documents existing good practice guidance that is relevant to the incorporation of aid in recipient country budgets; (b) reviews the policies and guidelines of the major multilateral and bilateral agencies as these affect the incorporation of their aid into government budgets; and (c) documents relevant experiences of efforts to capture aid in government budgets, including desk reviews of some additional countries, including countries from outside Africa.

A ***Synthesis Report*** which draws on all the other study components to develop overall findings and recommendations.

A ***Good Practice Note*** which distils the lessons of the study and is aimed at donors as well as partner governments.

Full reference details are given in the bibliography.

The reports can be downloaded from the CABRI website at http://www.africa-sbo.org/.

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Disclaimer

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This report was prepared by independent consultants. Responsibility for the contents and presentation of findings and recommendations rests with the study team.

The views and opinions expressed in the report do not necessarily correspond to the views of CABRI or SPA.

Putting Aid On Budget: Synthesis Report

Contents

Annexes [separate volume]

Boxes

Acronyms and Abbreviations

AAP	Assessment and Action Plans
AfDB	African Development Bank
AsDB	Asian Development Bank
AIMS	Aid Information Management System
AMP	Aid Management Platform (Ethiopia)
AOB	Aid On Budget
BoT	Bank of Tanzania
BF	Basket Funding
BS	Budget Support
CABRI	Collaborative Africa Budget Reform Initiative
CFAA	Country Financial Accountability Assessment
CIDA	Canadian International Development Agency
CIPFA	Chartered Institute of Public Finance and Accountancy
CPIA	Country Policy and Institutional Assessment
DAC	Development Assistance Committee (of OECD)
DFID	Department for International Development (UK)
EC	European Commission
FY	Fiscal Year
GBS	General Budget Support
GFS	Government Finance Statistics
GNI	Gross National Income
GPN	Good Practice Note
GTZ	German Agency for Technical Cooperation
HIPC	Heavily Indebted Poor Countries
IDB	Inter-American Development Bank
IFAC	International Federation of Accountants
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
IR	Inception Report
JAS	Joint Assistance Strategy
JICA	Japan International Cooperation Agency
LR	Literature Review
MCC	Millennium Challenge Corporation
MDAs	Ministries, Departments and Agencies
MDBS	Multi-Donor Budget Support
MTEF	Medium-Term Expenditure Framework
OECD	Organisation for Economic Co-operation and Development
ODA	Official Development Assistance
ODI	Overseas Development Institute
PBS	Protection of Basic Services (Ethiopia)
PD	Paris Declaration
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PFM	Public Finance Management
PIU	Project Implementation Unit
PRSP	Poverty Reduction Strategy Paper
RDP	Reconstruction and Development Programme (South Africa)
SBAS	Strategic Budget Allocation System (Tanzania)
SPA	Strategic Partnership with Africa
SR	Synthesis Report
SSA	Sub-Saharan Africa
STA	Single Treasury Account
SWAp	Sector-Wide Approach
TA	Technical Assistance
TOR	Terms of Reference
UN	United Nations
UNDP	United Nations Development Programme

1. INTRODUCTION

This chapter:

- *explains the objectives of this study;*
- *describes the study components that have fed into this Synthesis Report; and*
- *explains the structure of the Synthesis Report.*

Terms of Reference

1.1 The Paris Declaration has put the use of government systems at the centre of the international aid effectiveness agenda. Several of its indicators relate directly or indirectly to "putting aid on budget", which has thus gained prominence as a joint concern of governments and donors.

1.2 Against this background, the Collaborative Africa Budget Reform Initiative (CABRI) and the Strategic Partnership with Africa (SPA) commissioned the present study of putting aid on budget.[1] Full Terms of Reference (TOR) are at Annex A.[2] In essence, the study's aim is:

> *to produce outputs which will better equip governments in Sub-Saharan Africa to lead country-level processes to ensure external development assistance (aid) flows are properly reflected in national budget documents, ex ante (budget presented to legislature) and ex post (out-turn accounts).* (TOR,¶1)

1.3 The study is particularly intended to help Sub-Saharan countries which receive substantial aid flows. However its scope is broader. It is one of the first attempts to examine the issue of putting aid on budget in a more systematic way, drawing on evidence from a wide range of countries. The TOR required a literature review of existing good practice, a study of country practices in at least ten African countries, a more in-depth investigation of what works and what does not in some of the case study countries, and the preparation of a Synthesis Report (SR) and a Good Practice Note (GPN) based on the research results.

Approach and outputs

1.4 The study methodology is set out in the Aid On Budget Inception Report (Mokoro Ltd, 2007) and is strongly reflected in Chapter 2 below ("Basic concepts").

1.5 Case studies of ten SSA countries were the core of the study. Annex B assembles the main findings from all ten countries. A standard factual analysis was conducted in all of them, with more in-depth studies in five countries (those listed as "Group B" below). Free-standing reports on the Group B countries are also being published. These looked more closely at the reasons behind the levels of aid capture that were found. (See the Bibliography[3] for details of all the study outputs.)

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[1] The study has been funded by DFID with additional support from JICA.
[2] Annexes comprise a separate volume of this report.
[3] At the end of this volume.

CASE STUDIES

Group A	**Group B**
Burkina Faso	Ghana
Ethiopia	Mali
Kenya	Mozambique
South Africa	Rwanda
Tanzania	Uganda

1.6 The case studies did not involve a new quantitative survey. In each country, researchers assembled the best available information from existing sources[4] and focused especially on trying to explain the patterns of aid capture that were found. All the researchers were already familiar with the countries concerned, and they were assisted by the involvement of the Senior Budget Officers linked to CABRI and of key donor representatives. Drafts of the country findings were circulated to government and aid agency representatives for comment.

1.7 The research was supported by a Literature Review (Mokoro Ltd, 2008a) which has been published separately.[5] Box 1 shows the main requirements for the Literature Review and how they were addressed.

Box 1: The Aid On Budget Literature Review

The Aid On Budget Literature Review was required:

(a) **To document existing good practice guidance that is relevant to the incorporation of aid in recipient country budgets**.

Section A looks at the international good practice guidance for putting aid on budget and documents the literature on: sound budgeting and financial management and the implications for aid management; the aid effectiveness consensus and the good practice principles for putting aid on budget; and, how aid on budget is monitored.

(b) **To review the applicable policies and guidelines of the major multilateral and bilateral agencies as these affect the incorporation of their aid into government budgets.**

Section B provides illustrations of different donor approaches to putting aid on budget. The bilateral agencies covered are: Canada, Denmark, France, Germany, Ireland, Japan, the Netherlands, Norway, Sweden, the United Kingdom and the United States. The multilateral organisations covered are: the African Development Bank (AfDB), the Asian Development Bank (AsDB) and the Inter-American Development Bank (IDB), the World Bank, the International Monetary Fund (IMF), the European Commission (EC) and the United Nations (UN).

(c) **To seek and document relevant experiences of efforts to capture aid in government budgets, focusing mainly on countries that were not case-studies for the main Aid On Budget consultancy, including countries from outside Africa.**

Section C of the literature review supplements the core case studies by profiling six other countries: *African Region*: Botswana, Senegal; *Asian Region*: Bangladesh, Vietnam; and *Latin American Region*: Bolivia, Nicaragua.

[4] See Chapter 4 for discussion of available quantitative and standardised assessments.
[5] The free-standing Literature Review was made possible by additional support from JICA.

Structure of the Synthesis Report

1.8 An essential starting point is to be clear about concepts and definitions. Chapter 2 therefore highlights the multiple dimensions of "aid on budget", and the need for precision in the use of this and other terminology. This is closely linked to Chapter 3's review of the rationale for putting aid on budget. This provides the context and criteria for assessing the *quality* of aid capture. Chapter 3 also notes the most relevant donor diagnostics, good practice guidance and targets.

1.9 As noted earlier, this study did not undertake a country-by-country quantitative survey. Nevertheless, Chapter 4 reviews available evidence about the extent of aid capture at various stages in the budget process, and about the quality of the public finance management systems involved. This provides essential background for the case studies.

1.10 Chapter 5 explains the research methodology, including the choice of case study countries and the importance of understanding the perspectives and interests (hence the incentives) of various stakeholders involved with aid and budgeting. The effective capture of aid on budget is more than a technical matter: it requires a good understanding of the institutional setting in which it takes place.

1.11 Chapter 6 highlights the main findings and conclusions from the country case studies. These are systematically presented, country by country, in Annex B, and Chapter 6 therefore focuses on the main factors which help or hinder efforts to ensure that aid is usefully captured during the budget cycle.

1.12 Finally, based on these findings, Chapter 7 offers good practice recommendations for governments and aid agencies.

2. BASIC CONCEPTS

This chapter explains the concepts and terminology used throughout the report. It identifies different dimensions of "on budget" and draws attention to some common confusions.

Introduction

2.1 Discussions about "putting aid on budget" are easily undermined by inconsistencies in the use of terms and concepts. The Literature Review highlights different interpretations among donors[6] (see also the discussion in Chapter 5 below). It also notes that the lack of consensus on practical definitions was one of the main challenges facing the first survey on the implementation of the Paris Declaration. In this Chapter, therefore, we explain the principal concepts and definitions used in this study.

Aid

2.2 For the purposes of this study, "aid" means Official Development Assistance (ODA), as defined by the OECD's Development Assistance Committee (DAC).[7] ODA includes both grants and (soft) loans, as well as contributions in cash and in kind. Distinguishing between these different types of aid is important, since the use of particular forms of ODA affects the likelihood of aid being captured in budgets.

2.3 The relevant Paris Declaration indicators and targets cover all aid to the government sector (see Box 2).

Box 2: Paris Declaration commitments cover all aid to the government sector

The Paris Declaration commitment to put aid on budget covers all aid that is disbursed for the government sector, however the aid is executed. The OECD provided the following definition of "disbursements for the government sector" that were monitored for the aid on budget targets for the 2006 Survey:

> *The disbursement of ODA in the context of an agreement with the government sector including works, goods or services delegated or subcontracted by government to other entities (e.g. NGOs, private companies).*
>
> The government sector is defined as: *administrations – ministries, departments, agencies or municipalities – authorised to receive revenue or undertake expenditures on behalf of central government.* (OECD Development Assistance Committee, 2006b)

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[6] For brevity we use the term "donor" to cover all aid agencies providing ODA, including ODA loans/credits as well as grants.

[7] Grants or Loans to countries and territories on Part I of the DAC List of Aid Recipients (developing countries) which are: (a) undertaken by the official sector; (b) with promotion of economic development and welfare as the main objective; (c) at concessional financial terms [if a loan, having a Grant Element (q.v.) of at least 25 per cent]. In addition to financial flows, Technical Co-operation (q.v.) is included in aid. Grants, Loans and credits for military purposes are excluded. (*Development Co-operation Directorate, DAC's Glossary, www.oecd.org.*)

The different dimensions of "on budget"

2.4 The study is concerned with official government budgets. At one level, it should be apparent from the budget documents whether aid has been incorporated. However, this is not completely straightforward:

- Budgets may or may not show aid as a *source* of budget finance in general, and/or track the *use* of aid to particular expenditure lines.
- In either case, presentations may be highly aggregated or quite detailed.
- There may also be differences between the presentation of a budget ex ante (before expenditure takes place) and various ex post presentations. The final version of the budget typically takes account of adjustments during the year, and the record of actual expenditures against the budget may differ again.

2.5 Furthermore, there is rarely only one relevant budget:

- Budgets frequently appear in draft, final, and amended versions.
- There may be a multiplicity of government budgets. (This is typically the case in federal or other decentralised systems.)
- Even for a central government budget, there are numerous budget holders (and time lags before information reaches them).

2.6 Moreover, budget documents need to be seen as punctuation marks in a continuing budget process. Aid may feature more or less effectively at different stages of the budget process. "Aid on budget" correspondingly has different dimensions. Box 3 defines the dimensions on which this study focuses.

Box 3: Different dimensions of "on budget"/capturing aid

Term	Definition
On plan	Programme and project aid spending is integrated into spending agencies' strategic planning and supporting documentation for policy intentions behind the budget submissions.
On budget[8]	External financing, including programme and project financing, and its intended use are reported in the budget documentation.
On parliament (or "through budget")	External financing is included in the revenue and appropriations approved by parliament.
On treasury	External financing is disbursed into the main revenue funds of government and managed through government's systems.
On accounting	External financing is recorded and accounted for in government's accounting system, in line with government's classification system.
On audit	External financing is audited by government's auditing system.
On report	External financing is included in ex post reports by government.

***Source**:* Inception Report (Mokoro Ltd, 2007).

[8] It should be clear from the context if "on budget" is meant in a more general sense than this precise definition. We also use the term "on system" for this wider sense.

2.7 We used this framework in the country studies, and in our analysis of issues generally. We found it very helpful in clarifying the ambiguities which bedevil this subject, and it also provides the structure of country-by-country findings presented in Annex B.

2.8 Box 3 is not exhaustive: there are other dimensions of government systems that may also be relevant. "On procurement" is an example. Externally-financed expenditures may or may not follow the government's standard procurement procedures, and several of the country studies noted that the perceived quality of government procurement systems was also an important influence on the capture of aid in other dimensions.

Disbursement channels

2.9 When discussing the "on treasury" dimension, it is important to be precise about different possible disbursement channels for aid. We distinguish three main channels:

- Channel 1 is the normal channel used for government's own-funded expenditures. Aid is disbursed to the government's finance ministry (or "treasury"), from where it goes, via regular government procedures, to the ministries, departments or agencies (MDAs) responsible for budget execution. Note that Channel 1 funds may or may not be earmarked for specific expenditures.
- In Channel 2, external funds are provided directly to a particular MDA – most often a sector ministry,[9] and managed through special accounts outside of the regular government system. Thus, Channel 2 funds, although held by a government body, do not follow the normal government procedures.
- In Channel 3, expenditure is undertaken by the donor agency itself or by non-government agents on its behalf. Assets or services are delivered to the Government in kind, but government does not handle the funds itself.

2.10 It is important to note that:

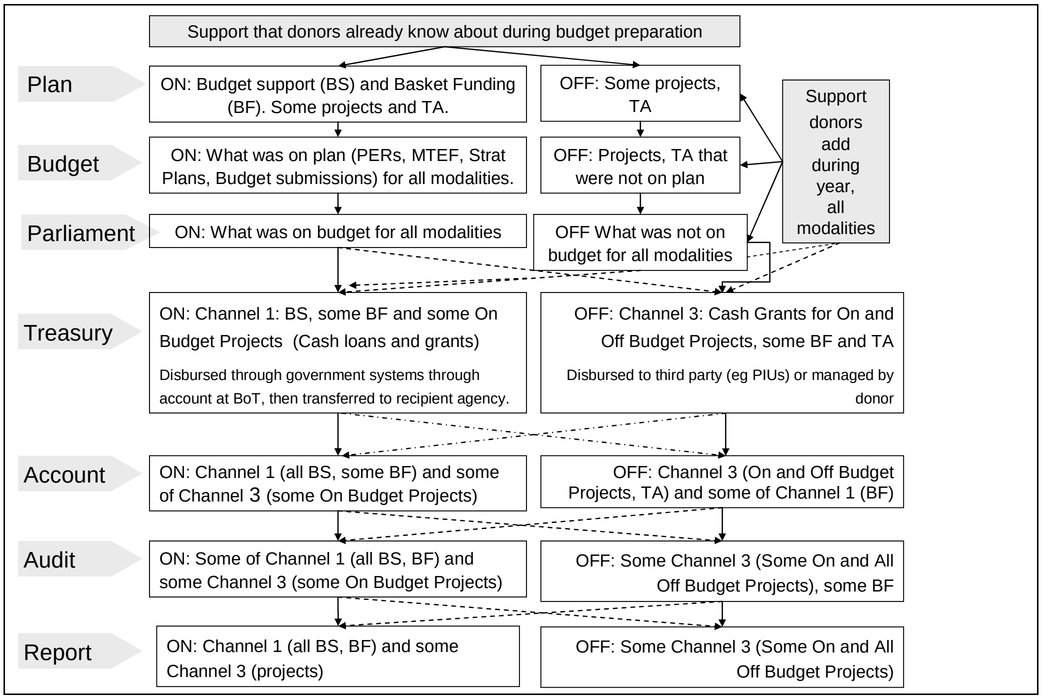
- Funds that are disbursed via government do not necessarily follow regular government channels, and may or may not be "on budget". This applies especially to Channel 2 funds, but can apply also to Channel 1.[10]
- Funds that are not disbursed via government (Channel 3) are often completely off-budget, but this need not be the case. It is possible for such funds to be anticipated in government plans and to be recorded in government budgets and accounts.

Complex patterns of aid capture

2.11 Aid may be captured on some of the dimensions defined in Box 3 above, and not on others. There are a large number of possible permutations, and the study's findings at country level reflect this complexity. Box 4 illustrates the pattern found in Tanzania.

[9] Channel 2 funds may be administered by a project implementation unit (PIU) under the control of government.
[10] For example UN system projects that follow "national execution" procedures are typically off-treasury, and often also off-budget in other relevant dimensions.

Box 4: Complex patterns of aid capture in Tanzania



Source: Aid On Budget Tanzania Case Study.

Misconceptions to avoid

2.12 The discussion of bringing aid on budget is often confused by misunderstanding of the issues. The following paragraphs clarify five such confusions.

(a) **"Aid on budget" is not a synonym for budget support.** To quote the definition used in the OECD DAC evaluation of general budget support:

> The general characteristics of **budget support** are that it is channelled directly to partner governments using their own allocation, procurement and accounting systems, and that it is not linked to specific project activities. All types of budget support include a lump sum transfer of foreign exchange; differences [e.g. between general and sector budget support] then arise on the extent of earmarking and on the levels and focus of the policy dialogue and conditionality. (IDD & Associates, 2006)

Thus, budget support is, by definition, on budget.[11] However, other aid modalities, including project aid, technical assistance and other forms of aid in kind can also be on budget.

(b) "Sector budget support", similarly, should be on budget by definition. But **the term "sector budget support" is often used inaccurately:**

- Part of the standard definition of budget support (above) is that it is not linked to specific project activities. However, in some country cases, the term "sector budget support" is used to describe funding that is very tightly earmarked ex ante to specific budget lines.[12]

[11] However, this study found examples where budget support was not made clearly visible in budget documents as a source of finance.
[12] See the Aid On Budget country case studies for Mali and Burkina Faso.

- Equally, sector budget support, by definition, uses government's own allocation, procurement and accounting systems. However, pooled funding arrangements that do not use regular government systems are often wrongly described as sector budget support.

(c) **The term Sector Wide Approach (SWAp) is not synonymous with pooled funding (or basket funds)**. The discussion about whether aid is on budget needs to consider specific aid instruments, but a SWAp is not itself a specific aid instrument but a way of working at sector level. A SWAp may be supported by a variety of aid instruments: a pooled donor fund is one possibility, but a SWAp may also (and at the same time) be supported by other instruments, including projects and both general and sector budget support. (OECD Development Assistance Committee, 2006b)

(d) **Projects are not necessarily off-budget.** The use of parallel systems is a very common feature of externally funded projects, and bypassing country systems has often been part of the rationale for using the project modality. However, it is quite possible for project aid to be on budget at some or all of the stages of the budget cycle. It is therefore very unhelpful to imply that the use of parallel systems is an automatic feature of project aid.[13] Using project terminology in this way can easily reinforce the misconception that shifting to budget support is the only way to bring more aid on budget.

(e) **Putting aid on budget is not just a matter of donors informing governments about their aid disbursements.** There is a fundamental difference between reporting aid on budget (providing information that can be included in budget documents), and integrating aid on budget (actually using government systems at the different stages of the budget cycle). Reporting and integration are not mutually exclusive activities, but reporting will not necessarily result in the same benefits as can be achieved from integration. (See additional discussion in Chapter 5 below, especially Box 17.)

[13] Some of the country case studies provide examples of such usage. Thus the Ghana country study noted:

> In Ghana, a project is considered to be a set of activities with a common objective managed by a project implementation unit and financed by resources which are kept in separate bank accounts (usually government-designated) not linked to the Consolidated Fund. (Aid On Budget Ghana Case Study)

A similar usage was found in Mali. (Aid On Budget Mali Case Study)

3. WHY SHOULD AID BE ON BUDGET?

This chapter explains the rationale for putting aid on budget and notes the main international commitments that support putting aid on budget.

Introduction

3.1 Judging whether aid is usefully captured in the budget process requires an understanding of why its capture is considered desirable. This Chapter summarises the reasons that are given for putting aid on budget. These are rooted in internationally accepted standards of public finance management (PFM) that apply equally to rich and poor countries and to both domestic and external resources. They are reflected in many governments' PFM reform agendas, in criteria for assessing PFM systems (especially the Public Expenditure and Financial Accountability – PEFA – diagnostic) and in international aid effectiveness commitments (encapsulated in the Paris Declaration, to which developing country governments as well as their aid partners are signed up).

Reasons for capturing aid[14]

3.2 The conventional wisdom about putting aid on budget draws on two interacting streams of thought – about public finance management, and about aid effectiveness. The underlying PFM arguments are about the comprehensiveness, transparency and accountability of government financial activities. These are reinforced by aid effectiveness arguments for strengthening government systems.

Sound budgeting and financial management

3.3 There is a consensus that sound budgeting and financial management is based on the following principles:

- Budgets need to be *comprehensive* – include all revenues and expenditures – to enable governments to follow good macroeconomic management and promote allocative efficiency.
- Fiscal *transparency* – decision makers have all relevant information – is a driving force for improving fiscal management.
- Transparency is also important to ensure *accountability* – decisions and their basis, results and costs are accessible, clear and communicated to the wider community – so that decision-makers are held responsible.

3.4 Aid is a substantial share of public resources for many developing countries and thus how aid is managed is an important determinant of overall public finance management. These good practice principles therefore imply that aid should be on budget.[15] If aid is not on budget then the budget cannot be comprehensive, there cannot be full transparency of information and neither can decision-makers be held to account. Failure to capture aid has repercussions on the effectiveness of domestic resources (their allocation is less efficient if based only on a partial view) and often leads to unsustainable patterns of expenditure.

[14] See the Literature Review for a fuller discussion.

[15] Putting aid on budget as good practice was identified in the 1990s in public finance management seminal texts by Schick (1998), the World Bank (1998) and the International Monetary Fund (1998). See the Literature Review for further detail.

Aid effectiveness

3.5 It is in recipients' own interests to maximise aid effectiveness by combining aid effectively with domestic resources. For their part, donors have both a developmental and a fiduciary interest in the quality of partner countries' public finance management. The OECD declared in 2006: *Effective public finance management is crucial to countries making progress in reducing poverty. It is fundamental to both government performance and successful aid delivery.* (OECD Development Assistance Committee, 2006b)

3.6 The Heavily Indebted Poor Countries (HIPC) initiative, focusing on the adequacy of government systems to allocate resources to pro-poor activities, and the Poverty Reduction Strategy (PRS) approach working to link priorities with domestic and external resources, have helped to focus attention on government strategic budgeting and allocative efficiency. As a result, donors have been paying more attention to the comprehensiveness and transparency of government budgets, and, as part of that, to what extent aid is and is not on budget.

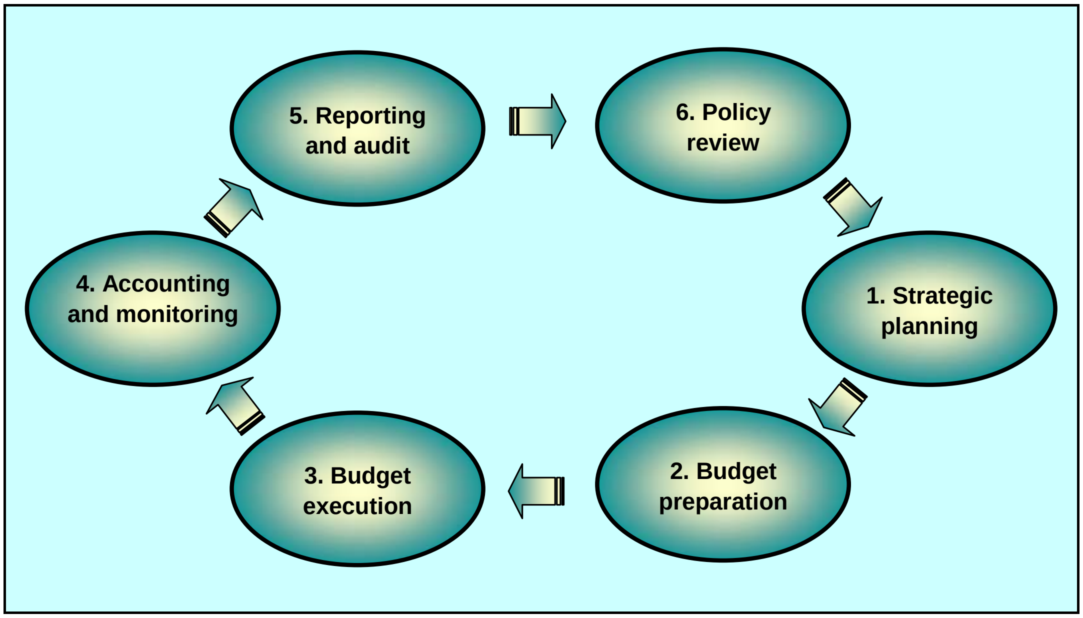
3.7 One important aim of the PRS approach was to provide a framework for facilitating donor alignment with country priorities and facilitating donor use of country systems to deliver aid. Revised assessments of the effectiveness of aid in the 1990s concluded that inappropriate aid modalities had been part of the problem. Sometimes the non-capture of aid by the government accounting system was a direct consequence of donor financing arrangements when accountability to donors was ensured at the expense of transparency and accountability in the recipient country (International Monetary Fund, 1998). There was also an issue of donor coordination, with the multiplicity of donors and their numerous programmes and projects making it difficult to keep track how much was being spent and on what. For governments, this was a distraction from management of their own resources and tended to undermine their capacity to formulate and implement coherent policies.

3.8 Hence, there is a general consensus today that effective aid relies on country ownership of strategy and country leadership of aid management. Good practice principles adopted at the High Level Forum in Rome in 2003 and further developed at the Paris High Level Forum in 2005 are based on the principle of donor alignment with partner countries' strategies and systems in order to ensure this country ownership. Using country systems is seen as an important way of strengthening them. It is also seen as a way of seeking sustainability, since parallel activities often wither when external funding ceases.

Aid and the budget cycle

3.9 As implied by the dimensions shown in Box 3 (Chapter 2 above), the alignment of aid with government systems should be seen in the context of the budget cycle. Aid may be (more or less) aligned with the government system during some stages of the budget cycle and not during others – as Box 4 illustrated for the case of Tanzania. And the rationale for aligning aid with the government systems is somewhat different for different parts of the cycle – as shown in Box 5.

Box 5: Aid capture and the budget cycle



Stage	**Relevance of capturing aid**
1. Strategic planning	Resource mobilisation; macroeconomic discipline; integration of aid financed and government financed programmes; policy coherence; allocative efficiency.
2. Budget preparation	Resource mobilisation; fiscal discipline; integration of aid financed and government financed programmes; allocative efficiency; policy and spending coherence; spending capacity assessment; financial sustainability, including links between capital and forward recurrent spending; clarity on government's co-financing commitments; executive authorities' decisions on trade-offs informed by view of aid; scrutiny by parliament.
3. Budget execution	Timely aid disbursement, integrated cash flow projections; strengthening of operational planning; strengthening of procurement, commitment and payment systems, lower transaction costs; improved efficiency through coherent programme implementation.
4. Accounting and monitoring	Strengthened accounting systems; integrated financial information; monitoring of and accountability for aid disbursement; monitoring of aid transfers to lower level agencies; comprehensive and integrated monitoring of spending programmes to identify problems early.
5. Reporting and audit	Accountability for budget execution and achievement of policy results.
6. Policy review	Understanding aid effectiveness, and the contribution of aid to overall results (to feed into strategic planning).

3.10 Whether capturing aid at any of these points will have the desired effects depends on:

- The quality of the information captured, in terms of its completeness, credibility (predictability), level of disaggregation and detail, etc.
- The ability to make use of the information, which will depend on its timeliness and accessibility (who has the information, and at what stage in the relevant process).

- The quality of the information and processes relating to non-aid resources. The benefits of capturing aid are likely to be limited if the processes for managing domestic resources are dysfunctional.

International standards and targets

Standards for Public Finance Management

3.11 Under the Public Expenditure and Financial Accountability (PEFA) initiative, a standardised PFM Performance Measurement Framework was launched in June 2005.[16] The framework includes a set of high level indicators (28 partner performance indicators and 3 donor performance indicators) which draw on a number of earlier assessment exercises and international standards (see the Literature Review Annex B for further details). The PEFA framework measures the operational performance of the PFM systems, processes and institutions against six core dimensions of PFM performance: credibility; comprehensiveness and transparency; policy-based budgeting; predictability and control in budget execution; accounting, recording and reporting; and external scrutiny and audit.

3.12 The full set of PEFA indicators is shown in Box 6, with the indicators of most direct relevance to putting aid on budget highlighted. However, none of these indicators addresses one dimension of putting aid on budget exclusively or precisely. Therefore they need to be interpreted with care (see further discussion in Chapter 4 below).

3.13 Various PEFA indicators are directly relevant to the extent that they provide information about the degree to which aid is captured in the budget system; indicators may also be indirectly relevant for the light they shed on aspects of the underlying PFM system that affect the scope for bringing aid on budget, or the quality of its capture in the budget system. The particular relevance of each of the highlighted indicators is as follows:

Indicator		**Relevance**
PI-5	classification of the budget	on budget, on account
PI-6	comprehensive of information included in the budget documentation	on plan, on budget, on parliament
PI-7	capture of income and expenditure information for donor funded projects, even if they are not technically on budget or are managed outside of government's budget management and accounting system.	on budget, on account, on report
PI-27	legislative scrutiny of the annual budget law	on parliament
PI-28	legislative scrutiny of external audit reports	on parliament, on audit
D-1	predictability of budget support	on plan, on budget
D-2	degree to which donors provide financial information for budgeting and reporting on project and programme aid	on plan, on budget, on parliament, on audit, on report
D-3	proportion of aid funds that are managed by the use of national procedures	on budget, on treasury, on audit

[16] The Framework was developed between 2003 and 2005 through extensive consultations, including with the DAC Joint Venture on PFM, a group of African PFM experts, and government representatives from Eastern Europe and Central Asia. Comments were also received from practitioners within the World Bank, IMF, other PEFA partners, government agencies and professional organizations. (PEFA Secretariat, 2006a)

Box 6: Overview of the PEFA indicator set

	A. PFM-OUT-TURNS: Credibility of the budget
PI-1	Aggregate expenditure out-turn compared to original approved budget
PI-2	Composition of expenditure out-turn compared to original approved budget
PI-3	Aggregate revenue out-turn compared to original approved budget
PI-4	Stock and monitoring of expenditure payment arrears
	B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency
PI-5	Classification of the budget
PI-6	Comprehensiveness of information included in budget documentation **NB coverage of aid funds or not does not explicitly enter this indicator.**
PI-7	Extent of unreported government operations **NB this is the key indicator of "capture" of donor funds in budgetary reports.**
PI-8	Transparency of inter-governmental fiscal relations
PI-9	Oversight of aggregate fiscal risk from other public sector entities.
PI-10	Public access to key fiscal information
	C. BUDGET CYCLE
	C(i) Policy-Based Budgeting
PI-11	Orderliness and participation in the annual budget process
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting
	C(ii) Predictability and Control in Budget Execution
PI-13	Transparency of taxpayer obligations and liabilities
PI-14	Effectiveness of measures for taxpayer registration and tax assessment
PI-15	Effectiveness in collection of tax payments
PI-16	Predictability in the availability of funds for commitment of expenditures
PI-17	Recording and management of cash balances, debt and guarantees
PI-18	Effectiveness of payroll controls
PI-19	Competition, value for money and controls in procurement
PI-20	Effectiveness of internal controls for non-salary expenditure and assets management
PI-21	Effectiveness of internal audit
	C(iii) Accounting, Recording and Reporting
PI-22	Timeliness and regularity of accounts reconciliation
PI-23	Availability of information on resources received by service delivery units
PI-24	Quality and timeliness of in-year budget reports
PI-25	Quality and timeliness of annual financial statements
	C(iv) External Scrutiny and Audit
PI-26	Scope, nature and follow-up of external audit
PI-27	Legislative scrutiny of the annual budget law
PI-28	Legislative scrutiny of external audit reports
	D. DONOR PRACTICES
D-1	Predictability of Direct Budget Support
D-2	Financial information provided by donors for budgeting and reporting on project and program aid
D-3	Proportion of aid that is managed by use of national procedures

Source: PEFA Secretariat, 2006a.

Box 7: Paris Declaration commitments to put aid on budget

Ownership

(14) *Partner countries commit to:*

- Exercise leadership in developing and implementing their national development strategies through broad consultative processes.
- Take the lead in co-ordinating aid at all levels in conjunction with other development resources in dialogue with donors and encouraging the participation of civil society and the private sector.

(15) *Donors commit to:*

- Respect partner country leadership and help strengthen their capacity to exercise it.

Alignment

Donors align with partners' strategies

(16) *Donors commit to:*

- Base their overall support — country strategies, policy dialogues and development co-operation programmes — on partners' national development strategies and periodic reviews of progress in implementing these strategies (Indicator 3).

Donors use strengthened country systems

(21) *Donors commit to:*

- Use country systems and procedures to the maximum extent possible. Where use of country systems is not feasible, establish additional safeguards and measures in ways that strengthen rather than undermine country systems and procedures.
- Avoid, to the maximum extent possible, creating dedicated structures for day-to-day management and implementation of aid-financed projects and programmes.

Strengthen public financial management capacity

(25) *Partners commit to:*

- Publish timely, transparent and reliable reporting on budget execution.

(26) *Donors commit to:*

- Provide reliable indicative commitments of aid over a multi-year framework and disburse aid in a timely and predictable fashion according to agreed schedules (Indicator 7).
- Rely to the maximum extent possible on transparent partner government budget and accounting mechanisms (Indicator 5).

Harmonisation

Donors implement common arrangements and simplify procedures

(32) *Donors commit to:*

- Implement, where feasible, common arrangements at country level for planning, funding (e.g. joint financial arrangements), disbursement, monitoring, evaluating and reporting to government on donor activities and aid flows. Increased use of programme-based aid modalities can contribute to this effect (Indicator 9).

Deliver effective aid in fragile states

(39) *Donors commit to:*

- Avoid activities that undermine national institution building, such as bypassing national budget processes or setting high salaries for local staff.

Managing for Results

(44) *Partner countries commit to:*

- Strengthen the linkages between national development strategies and annual and multi-annual budget process.

Mutual Accountability

(48) *Partner countries commit to:*

- Strengthen as appropriate the parliamentary role in national development strategies and/or budgets.

(49) *Donors commit to:*

- Provide timely, transparent and comprehensive information on aid flows so as to enable partner authorities to present comprehensive budget reports to their legislatures and citizens.

Source: High Level Forum, 2005.

3.14 Several of the other PEFA indicators also influence the potential benefits of putting aid on budget and donors' willingness to put aid on budget. (For example, PI-12 – multi-year perspective in fiscal planning, expenditure policy and budgeting – is highly relevant to the "on plan" dimension.) Moreover, the score for most indicators draws on several different sub-components. In some cases it may be worth highlighting specific sub-indicators (for example, component (i) of indicator PI-7 does not relate to aid, but component (ii) focuses explicitly on the capture of aid in fiscal reports).

Relevant Paris Declaration commitments and targets

3.15 The Paris Declaration includes a wide range of reciprocal commitments by aid agencies and partner governments. These are relevant to putting aid on budget at all points of the budget cycle (see Box 7 above).

3.16 The Paris Declaration is supported by a set of 12 indicators with targets for 2010, developed to track and encourage progress against the broader set of partnership commitments. Three of these indicators are directly concerned with putting aid on budget, as shown in Box 8.

Box 8: Paris Declaration indicators and targets for putting aid on budget

Indicator	***Monitoring***	***Target***
Indicator 3: Aid flows are aligned on national priorities	The gap between what was disbursed by donors for the government sector and what was actually recorded in the annual budget by government.	Halve the proportion of aid flows to government sector not reported on government's budget(s) (with at least 85% reported on budget)
Indicator 5a: Use of country PFM systems	The volume of aid and the percentage of donors that uses a partner country PFM system as a percent of total aid provided to the government sector. Looks at the three components of a country's PFM procedures: i) national budget execution procedures ii) national financial reporting procedures iii) national auditing procedures.	Score 5+: all donors use partner countries PFM systems and a two-thirds reduction in the % of aid to the public sector not using partner countries PFM systems; Score 3.5–4.5: 90% all donors, and a one third reduction[17]
Indicator 7: Aid is more predictable	The gap between aid scheduled and aid effectively disbursed and recorded in countries accounting systems. (Focuses specifically on in-year predictability of aid flows to the government sector.)	Halve the proportion of aid not disbursed within the fiscal year for which it was scheduled.

Source: High Level Forum, 2005; OECD Development Assistance Committee, 2006a.

[17] These are World Bank Country Policy and Institutional Assessment (CPIA) scores. See Box 11 in Chapter 4 below.

Other international standards

3.17 There are other international standards and processes which are also focusing attention on putting aid on budget. The IMF Code and Manual of Good Practice on fiscal transparency (first introduced in 1998, revised version in April 2007) has new recommendations to strengthen the standard for reporting on external financing, calling for separate identification of aid in the budget.[18] Also relevant has been the work on the 2003 International Public Sector Accounting Standard (IPSAS) for cash-based financial reporting to develop mandatory and optional ("encouraged") disclosures on official development assistance. The cash-based standards are especially relevant to developing countries as the vast majority of their governments do not have accrual-based systems. (See also Box 30 in Chapter 6 below.)

3.18 Next, in Chapter 4 we review what is known about international performance against the key aid-on-budget indicators and targets described above.

[18] *3.1.4 Receipts from all major revenue sources, including resource-related activities and foreign assistance, should be separately identified in the annual budget presentation.* (International Monetary Fund, 2007b)

4. HOW MUCH AID IS ON BUDGET?

This chapter provides an overview of international efforts to monitor the proportion of aid that is on budget and draws some tentative conclusions.

Introduction

4.1 This Chapter assembles international data from various diagnostic instruments and surveys. It compares data for the ten main case study countries, plus some additional comparators. Some initial warnings are necessary: (a) in most cases the data were not designed to permit international comparisons, and therefore need to be treated very cautiously; (b) equally, there is a lack of reliable time series within countries; (c) the aid on budget case studies, and other observers, have highlighted further weaknesses in the main indicator set, from the baseline survey on the implementation of the Paris Declaration.

Survey of Paris Declaration implementation

The Paris Declaration 2006 Monitoring Survey

4.2 The Paris Declaration 2006 Monitoring Survey reports on aid flows in 2005. Its data were collected from 34 self-selected countries and a comprehensive list of donor organisations covering 37% of the global aid programme (OECD, 2007a). Of the data available on country experiences of putting aid on budget, the Paris Declaration monitoring is the only quantified cross-country (and cross-donor) survey.

4.3 However, this survey experienced difficulties in the consistency of application of definitions. Its permitted leeway on the local application of definitions makes its data unreliable for comparisons across countries. The survey report recommends a more rigorous standardisation of measures for the next survey round (which is in 2008).[19] These problems have already undermined the possibility of reliable comparisons, even at the individual country level, between the 2006 and 2008 surveys on the indicators most relevant to putting aid on budget.

Country performance

4.4 Box 9 shows Paris Declaration (PD) monitoring declaration data for the ten main case study countries. The survey was designed to set a baseline for measurement of progress on the PD indicators; its reference year is 2005 (or FY 2004/05 when the fiscal year does not match the calendar year). The survey's categories correspond only approximately to some of the on-budget dimensions identified for the present study. Moreover, the way the baseline is assessed includes some upward biases:

- The indicator does not distinguish between over-recording and under-recording of aid in the budget. Moreover, the aid recorded as spent may not be the same (in its source or in its use) as the aid anticipated in the budget. Thus similarity between ex ante and ex post totals may be coincidence.
- As the Literature Review describes, countries were allowed some latitude in interpreting definitions, and the survey's compilers themselves point out that this is likely to have biased scores upwards (notably in the criteria applied for the use of country systems).

[19] See the Literature Review (especially its Box 8) for a full discussion.

4.5 Doubts over the reliability of the Paris Declaration data were reinforced by observations from several of the aid on budget country case studies:

- The reports for Ghana and Mali noted the lack of transparency in how the reported PD scores were calculated; this makes it difficult to verify the scores, and will cause problems in ensuring within-country comparability between this survey and subsequent ones.
- For Uganda, it was reported by some donors, in particular the World Bank, that project aid used government budget execution systems, but this is not the case, and the survey generally seems to provide an over-optimistic assessment of aid capture (see Aid On Budget Uganda Case Study, Box 7).
- The Rwanda report highlights reservations (on the part of the Rwanda government as well as some donors) about how much aid is properly described as "aid to the government sector". This may make a large difference to the denominator in calculating the proportion of aid on budget, and could make a huge difference to some donors' scores.
- The South Africa study finds that aid is not systematically incorporated in the budget. However, the PD survey's score for indicator 3 is based on the fact that some aggregate information on past, current and expected forward flows into the Reconstruction and Development (RDP) Fund (a fund established at national level to receive aid flows) appears in a couple of tables in the Budget Review.

Donor performance

4.6 Box 10 shows selected donors' performance against Paris Declaration indicators 3, 5a and 7. These data are subject to the same caveats as the country performance data. Moreover they are based on a (self-selected) subset of the countries to which these agencies provide aid, and therefore cannot be assumed to be representative of each agency's entire portfolio.

Consolidated data on PFM performance

4.7 Box 11 consolidates Paris Declaration monitoring scores with other PFM diagnostic scores for indicators that measure the extent of aid capture on budget. The data set includes HIPC Assessment and Action Plans (AAPs), World Bank Country Policy and Institutional Assessments (CPIAs), PEFA Assessments, and the Paris Declaration 2006 Monitoring Survey.

4.8 Once again, caveats are required. The HIPC AAP scores provide comparisons between 2001 and 2004 assessments, but the indicators are much cruder and less transparent than the subsequent PEFA diagnostic. On the other hand, none of the PEFA indicators address the dimensions of putting aid on budget exclusively or precisely. Therefore they need to be interpreted with care, as detailed further in Annex B of the Literature Review. It is also important to note that cross-country comparison of PEFA indicators was never an objective of the Framework.[20]

[20] The PEFA *Report on Early Experience* details why such a comparison is difficult:

- *Comparison between two countries only makes sense on indicators for which the compliance with scoring methodology is high in order to ensure consistency and adequate documentation for differences; on the current stock of reports that limits the countries for which such a comparison can be meaningfully taken.*
- *Comparison of a country's performance against relevant global and regional averages requires that assessments have taken place in a significant number of countries with comparable characteristics, which is not yet the case.* (PEFA Secretariat, 2006b)

Box 9: Paris Declaration monitoring data for case study countries

Data for 2005		Burkina Faso	Ethiopia	Ghana	Kenya	Mali	Moz.	Rwanda	South Africa	Tanzania	Uganda
Core aid (1) reported to the DAC	USDm	688	1,333	1,147	793	714	1,326	545	759	1,543	1,126
Aid reported in 2006 survey (2)	USDm	593	1,288	1,047	667	625	1,267	571	583	1,433	1,088
Total budget support disbursed	USDm	168	356	296	65	124	337	198	0	573	391
	% of total aid	28%	28%	28%	10%	20%	27%	35%	0%	40%	36%
Total aid disbursed to government sector	USDm	531	1,048	946	456	557	1,133	554	351	1,294	854
On plan	% total disbursements										
On budget	% of donor commitments reported in budget estimate	75%	74%	90%	67%	60%	77%	52%	69%	82%	89%
	% of donor disbursements reported in budget estimate	68%	74%	96%	91%	60%	83%	49%	71%	90%	79%
On parliament (3)	% total disbursements	68%	74%	96%	91%	60%	83%	49%	0%	90%	79%
On treasury	% total disbursements	44%	58%	69%	47%	32%	40%	37%	36%	76%	66%
On account	% total disbursements	50%	45%	61%	46%	29%	35%	40%	42%	61%	48%
On audit	% total disbursements	40%	32%	56%	49%	28%	33%	40%	36%	61%	66%
On report	% total disbursements										

Source: Paris Declaration 2006 Monitoring Survey (OECD, 2007a).

Notes:

(i) 'Core aid' matches closely the definition used in the PD 2006 Monitoring Survey; it excludes debt reorganisation and humanitarian aid.
(2) For the PD 2006 Monitoring Survey the aid coverage by country ranged from 62% to 118% (survey report says differences could be due to aid from other donors, variations in timing of recording the flows and slight differences of definition) (OECD, 2007a)
(3) On parliament scores are repeats of the on budget scores, on the basis that the country parliaments approve the national budget presented by the government, which includes the aid on budget. An exception is South Africa where aid is not approved (as part of the budget or separately) by Parliament.

- The extent of capture of aid at the different dimensions of the budget could be either an "over" or "under" capture of aid. This is not shown by the percentages as presented above.
- On plan and on report dimensions were not assessed by the PD 2006 Monitoring Survey.

Box 10: Donor ratios for indicators relevant for putting aid on budget

		Aggregate	AfDB	AsDB	Canada	Denmark	EC	France	Germany	IDB	Ireland	Japan	Netherlands	Norway	Sweden	UK	UN	US	World Bank
3. Aid flows aligned																			
Government budget estimates of aid flows as % of aid disbursed for the government sector	*baseline ratio*	88%	95%	88%	75%	47%	81%	52%	55%	60%	48%	68%	70%	56%	49%	84%	30%	90%	94%
	country average	42%	59%	62%	51%	47%	56%	43%	50%	48%	48%	30%	44%	57%	35%	45%	34%	30%	62%
5a. Use of country PFM systems																			
% aid flows disbursed for government sector that use national PFM systems	*baseline ratio*	40%	33%	69%	42%	29%	40%	28%	35%	45%	90%	29%	71%	61%	47%	75%	18%	10%	42%
	country average	33%	28%	56%	35%	27%	38%	28%	28%	29%	90%	16%	60%	56%	40%	53%	15%	15%	36%
7. Aid is more predictable																			
Government acounts of disbursements as % of aid scheduled by donors for disbursement	*baseline ratio*	70%	56%	91%	73%	49%	65%	45%	75%	82%	72%	66%	65%	50%	54%	90%	32%	45%	68%
	country average	41%	52%	86%	42%	50%	49%	30%	48%	88%	63%	34%	52%	55%	48%	48%	18%	26%	63%

Source: Paris Declaration 2006 Monitoring Survey (OECD, 2007a). (From Literature Review, Table A5)

Notes:

- General note: The extent of capture of aid at the different dimensions of the budget could be either an "over" or "under" capture of aid. This is not shown by the percentages as presented above.
- The baseline ratio is a weighted average, based on each donor's portfolio in the surveyed country. It is the Paris Declaration Survey results for the base year of 2005. It is the aggregate value of the numerator divided by the aggregate value of the denominator; i.e. each country is weighted by the volume of the activity. (OECD, 2007a)
- The country average is an unweighted average. It provides a comparative measure of the baseline irrespective of the volume of activity in each country; i.e., it gives equal weight to each country). (OECD, 2007a)
- The guidance for the Paris Declaration Monitoring survey included encouragement to UN agencies to report both individually and collectively in completing the Survey. In the Survey report the UN information was reported in total for the UN.

Box 11: Consolidated country ratings

	Paris Declaration (2005)			PEFA Assessments (assessment carried out 2006 or 2007) (*1)								HIPC AAP	CPIA
	Indicator 3: % aid flows reported on budget	Indicator 5a: % aid flows using country PFM	Indicator 7: % aid disbursed as scheduled	PI-5	PI-6	PI-7	PI-27	PI-28	D-1	D-2	D-3	Indicator 4 (2004 and scores in brackets for 2001) (*2)	Indicator 13 (2006) (*3)
				Budget		Oper-ations	Audit		Donor practices				
Averages	**88%**	**40%**	**70%**										**3.2**
Bangladesh	88%	53%	91%	C	C	D	D	C	B	C	B	n/a	3.0
Bolivia	71%	26%	63%	No assessment planned								A (A)	3.5
Botswana	n/a	n/a	n/a	Assessment draft report planned early 2008								n/a	n/a
Burkina Faso	68%	45%	92%	A	A	B+	B+	C+	A	C+	C	C (C)	4.0
Ethiopia	74%	45%	96%	A	B	D+	D+	C+	C	C	Unable to score	B (B)	4.0
Ghana	96%	62%	92%	B	C	A	C+	C+	C+	C	D	B (B)	4.0
Kenya	91%	47%	44%	C	B	C	D+	D+	D	D	D	n//a	3.5
Mali	60%	29%	71%	C	C	C+	B+	D	D	D+	D	B (B)	3.5
Mozambique	83%	36%	70%	B	B	C+	B+	C+	C+	D+	D	B (B)	3.5
Nicaragua	73%	44%	70%	Assessment completed December 2006, not publicly available								scores not given	4.0
Rwanda	49%	39%	66%	A	D	B	C+	D+	B+	D	D	B (B)	4.0
Senegal	89%	23%	69%	Assessment commenced 2007								B (B)	3.5
South Africa	71%	38%	44%	No assessment planned								n/a	n/a
Tanzania	90%	66%	70%	C	A	B	C+	C	A	C	C	B (B)	4.5
Uganda	79%	60%	84%	B	B	C	C+	D+	C+	D+	C	B (A)	4.0
Vietnam	81%	32%	78%	Assessment commenced 2008								n/a	4.0

Source: Literature Review, Table D3.

Notes:

(*1) The PEFA indicators are: PI-5 Classification of the budget, PI-6 Comprehensiveness of information included in budget documentation, PI-7 Extent of unreported government operations, PI-28 Legislative scrutiny of the external audit reports, D-1 Predictability of Direct Budget Support, D-2 Financial information provided by donors for budgeting and reporting on project and programme aid and D-3 Proportion of aid that is managed by use of national procedures.
(*2) HIPC Assessment and Action Plans include assessment of the extent to which donor funds are included in central, state and local governments' budget(s) and/or fiscal reports. The definition of aid on budget used in the AAPs is broad (no disaggregation of aid on budget at different dimensions of the budget cycle and ex ante and ex post reporting by donors included in same indicator) and the AAP answers on the extent to which aid is on budget are not precise (general grades used of 'all', 'incomplete', 'none'). (Se LR Annex B for more detail.)
(*3) These scores are taken from the 2006 results of the World Bank annual Country Policy and Institutional Assessment (CPIA) exercise which covers the IDA eligible countries. Indicator 13 is the quality of budgetary and financial management.

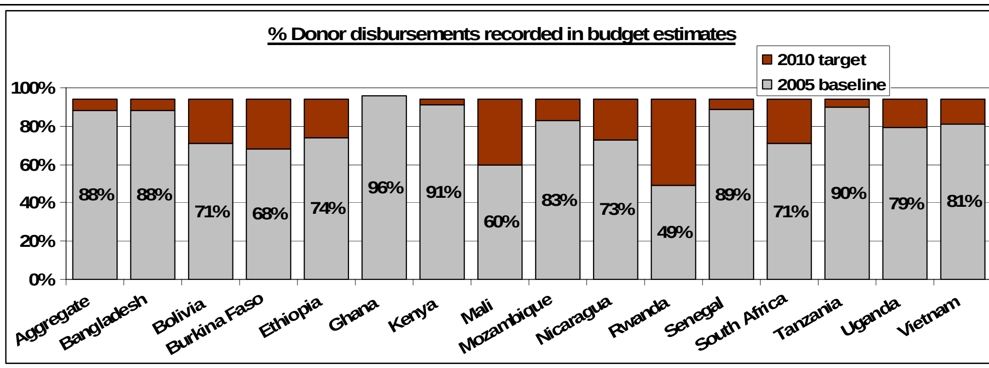
Conclusions from the data

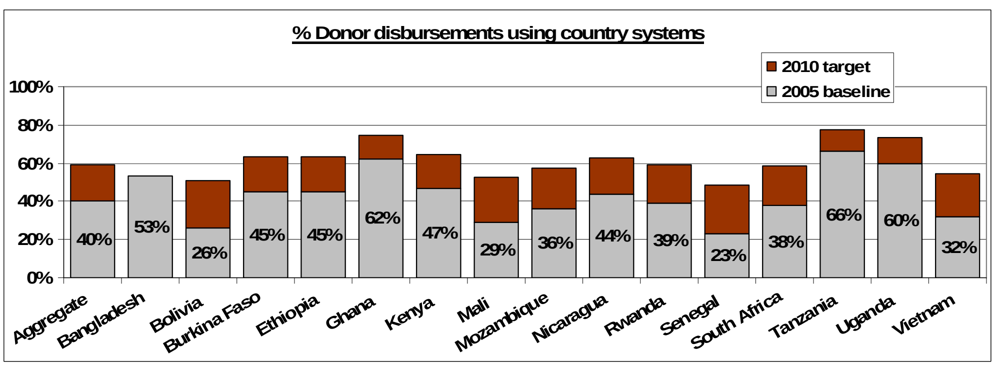
4.9 Efforts to assess the extent of aid flow capture and the quality of that capture have become increasingly systematic. As detailed in the paragraphs above, there are major limitations in coverage and consistency of the data. However, it supports the following broad conclusions.

Large volumes of aid are (still) off-budget

4.10 Box 12 depicts the PD survey's findings (country-wise) for PD indicators 3 and 5a. Results for indicator 3 "donor disbursements recorded in budget estimates" are in aggregate high (88%) and with a number of countries with over 80% of aid recorded on budget (Bangladesh, Ghana, Kenya, Mozambique, Senegal, Tanzania and Vietnam). However, both in aggregate and at country level, the survey results seem likely to overestimate the extent of aid capture (see ¶4.4 above). The survey's findings show that there is much less aid using country systems than is captured in the budget documents.[21]

Box 12: Paris Declaration monitoring – country results for indicators 3 and 5a





Source: For the full set of detailed figures see Literature Review, Annex A.

Notes: The 2010 targets are set as follows:

Indicator 3 target: Halve the proportion of aid flows to government sector not reported on government's budget(s) (with at least 85% reported on budget).

Indicator 5a target:

- *World Bank CPIA score 5+: all donors use partner countries' PFM systems and a two-thirds reduction in the % of aid to the public sector not using partner countries PFM systems;*
- *CPIA Score 3.5–4.5: 90% all donors, and a one third reduction.*

[21] The "using country systems" percentages in Box 12 are the average use of country systems of budget execution, financial reporting and audit; for separate estimates of each element, see Box 9 above.

4.11 Low scoring is also noticeable for the three donor performance indicators in the PEFA indicator set, that measure the predictability of direct budget support (D-1), the financial information provided by donors for budgeting and reporting on project and programme aid (D-2) and the proportion of aid that is managed by use of national procedures (D-3). D-2 and D-3 are especially relevant. The scores recorded against these criteria are almost without exception consistently low across the countries assessed (and for which the PEFA scores are available), as Box 13 shows. (See also Box 16, at the end of this chapter, which shows the rank order of country ratings against the indicators shown in Box 13.)

Box 13: PEFA performance indicator scores across countries

Indicator		A	B+	B	C+	C	D+	D
B. Key Cross-cutting issues: Comprehensiveness and Transparency								
PI-5	Classification of the budget	6%	0%	35%	6%	53%	0%	0%
PI-6	Comprehensiveness of information included in budget documentation	16%	0%	47%	5%	26%	0%	5%
PI-7	Extent of unreported government documentations	12%	6%	18%	18%	18%	24%	6%
C(iii) Accounting, Recording and Reporting								
PI-27	Legislative scrutiny of the annual budget law	0%	16%	0%	37%	11%	26%	11%
PI-28	Legislative scrutiny of the external audit reports	0%	0%	6%	13%	25%	31%	25%
D. Donor practises								
D-1	Predictability of direct budget support	25%	0%	8%	17%	17%	17%	17%
D-2	Financial information provided by donors for budgeting and reporting on project and programme aid	14%	0%	0%	7%	21%	36%	21%
D-3	Proportion of aid that is managed by use of national procudures	0%	0%	8%	0%	42%	0%	50%
All	**Average of 31 indicators**	**10%**	**3%**	**14%**	**14%**	**22%**	**21%**	**17%**

Source: PEFA Secretariat, 2006b.

Note: The country set for this data is Afghanistan, Bangladesh, Congo Brazzaville, Fiji, Ghana, Guatemala, Kyrgyz Republic, Lesotho, Malawi, Moldova, Mozambique, Panama, Papua New Guinea, Syria, Tanzania, Uganda, Zambia. Not all these reports are publicly available.

Levels of aid on budget are strongly driven by budget support aid (which by definition is on budget). In many cases off-budget proportions for other aid modalities still remain very high.

4.12 Budget support is by definition on budget. Therefore, taking budget support as fully captured on budget, it is possible to infer the (limited) extent of capture of other modalities. Taking the example of Rwanda:

> "49% of total ODA provided to Rwanda in 2005 was recorded in the national budget. If one takes into account that budget support represents approximately 41%[22] of total ODA disbursed to Rwanda in 2005 and that budget support is 100% accounted for in the budget, this would imply that project support is very badly captured in the national budget." (Aid On Budget Rwanda Case Study: 23.)

[22] Government of Rwanda source for budget support statistics, which records budget support at circa 6% more of total aid than as recorded by the Paris Declaration 2006 Monitoring Survey.

4.13 The Paris Declaration 2006 Monitoring Survey captures the amount of aid provided as budget support. This makes it possible to calculate how much of the aid included in government budget estimates is additional to budget support. Box 14 uses the PD Survey data to show what proportion of aid on budget is budget support, and how much other aid (*not* budget support) to the government sector is on budget. The data has been organised in order of percentage capture of other aid to the government sector that is on budget.[23] This is done in order to see whether the countries that receive a lot of budget support are also good at putting their other (project) aid on budget. If anything, the opposite seems to be the case. The countries which have the lowest proportions of non-budget-support (project) aid on budget include many of the largest recipients of budget support.

4.14 The extent of capture of other modalities on treasury is even weaker. As noted in Chapter 2, there are some countries where it is taken as axiomatic that projects are off treasury (see ¶2.12(d) above).

Large (and sometimes puzzling) differences in donor scores.

4.15 The Paris Declaration 2006 Monitoring Survey reports that for the extent to which donors' disbursements are recorded in governments' budget estimate, the detailed figures reveal quite "striking differences" among donors that are involved in similar numbers and types of countries (OECD, 2007a). However, the limited consistency in the application of definitions, across both donors and countries, means that it is not possible to draw conclusions from this data.

4.16 Looking at issue of disbursement according to schedule, the Survey finds that a few of the major donors are substantial under- or over-disbursers, but concludes that it is unclear if there is an explanation related to the subset of surveyed countries where those agencies are involved. (ibid.)

Lack of strong correlation between aid-on-budget and scores for quality of public finance management.

4.17 There is considerable variation in the use of country systems across countries and the correlation between the quality of the country PFM system and the use being made of them by donors is rather weak[24] – see Box 15. Countries such as Bangladesh, Mozambique or Kenya, whose PFM systems are not too good, as captured by the World Bank's CPIA index, have achieved levels of aid capture on budget comparable to those of countries with better CPIA scorings on the quality of their PFM systems. On the other hand, countries such as Vietnam or Ethiopia, whose PFM systems are rated among the best of this group of countries, are amongst those with lower proportions of aid making use of national PFM systems.

4.18 This suggests that factors other than the quality of systems are affecting donors' willingness to use them. (The country case studies suggest that the other factors involved may include political relationships and perceptions about countries' willingness to address PFM weaknesses.)

Quality is crucial

4.19 For aid effectiveness, it very important to look behind the percentages and consider the quality of aid capture at different stages in the budget process. This is the main focus of the country case studies reviewed in Chapter 6.

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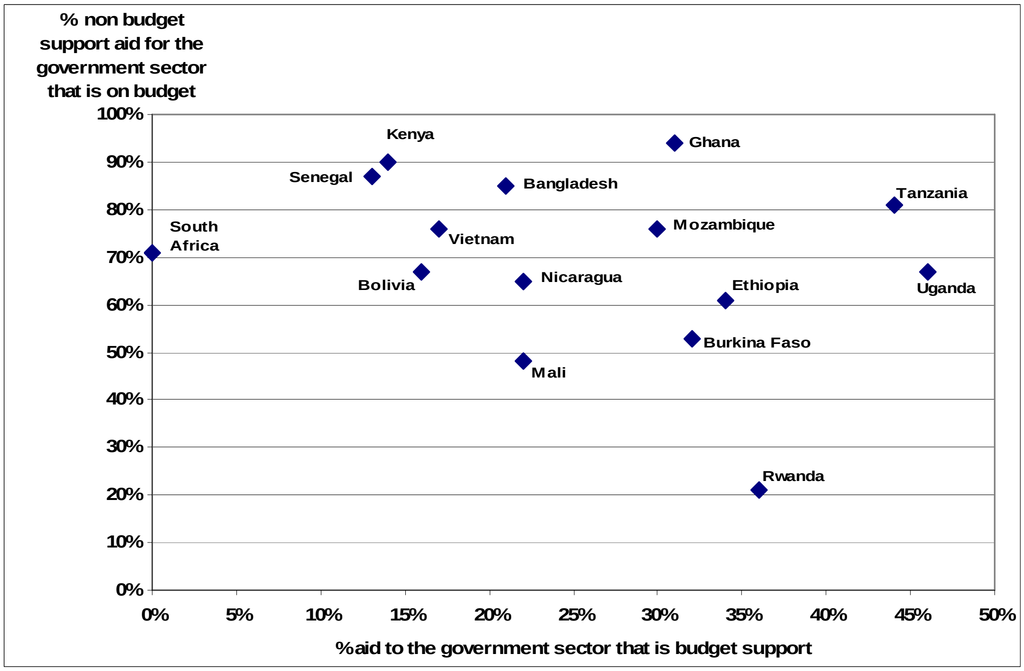
[23] As discussed in ¶4.4–4.5 (of the Synthesis Report), these data are at the upper limits due to the methodological upward biases.
[24] The Paris Declaration 2006 monitoring survey draws attention to this point (OECD, 2007a).

Box 14: Paris Declaration Survey budget support and on-budget data[25]



Data

	ODA			Aid disbursed for government sector				
	1	2	3	4	5	*5(i)*	*5(ii)*	6
					Share recorded on budget			
	Total	Budget support	Other aid modalities	Total	Baseline ratio of aid on budget	*Budget support as share of aid for government sector*	*Proportion of baseline ratio (col.5) that is not budget support*	Share non budget support aid for government sector that is on budget
	USDm	%	%	USDm	%	*%*	*%*	*%*
Rwanda	571	35%	65%	554	49%	*36%*	*13%*	*21%*
Mali	625	20%	80%	557	60%	*22%*	*38%*	*48%*
Burkina Faso	593	28%	72%	531	68%	*32%*	*36%*	*53%*
Ethiopia	1,288	28%	72%	1,048	74%	*34%*	*40%*	*61%*
Nicaragua	533	17%	83%	418	73%	*22%*	*51%*	*65%*
Bolivia	791	13%	87%	628	71%	*16%*	*55%*	*67%*
Uganda	1,088	36%	64%	854	79%	*46%*	*33%*	*67%*
South Africa	583	0%	100%	351	71%	*0%*	*71%*	*71%*
Mozambique	1,267	27%	73%	1,133	83%	*30%*	*53%*	*76%*
Vietnam	1,956	17%	83%	1,941	81%	*17%*	*64%*	*76%*
Tanzania	1,433	40%	60%	1,294	90%	*44%*	*46%*	*81%*
Bangladesh	1,837	16%	84%	1,414	88%	*21%*	*67%*	*85%*
Senegal	515	12%	88%	453	89%	*13%*	*76%*	*87%*
Kenya	667	10%	90%	456	91%	*14%*	*77%*	*90%*
Ghana	1,047	28%	72%	946	96%	*31%*	*65%*	*94%*

Source: OECD, 2007a; OECD, 2007b.

Notes: **ODA:** Official Development Assistance (ODA) includes all transactions as defined in OECD-DAC Statistical Directives para. 35, including official transaction that: 1) are administered with the promotion of the economic development and welfare of developing countries as its main objective; and 2) are concessional in character and convey a grant element of at least 25%. Excluded from the scope of the survey are: transactions made to beneficiaries not based in the country receiving ODA or to regional organisations, debt reorganisation/restructuring and emergency and relief assistance. **Aid disbursed for government sector:** as reported by donors, the disbursement of ODA in the context of an agreement with the government sector administrations – ministries, departments, agencies or municipalities – authorised to receive revenue or undertake expenditures on behalf of central government) including works, goods or services delegated or subcontracted by government to other entities (e.g. NGOs, private companies). **Total aid recorded on budget:** included in the budget estimate. As reported by government, ODA recorded in the annual budget as revenue or grants. *(Notes continued overleaf.)*

[25] This is the revised Box 14 issued 7 May 2008.

(Box 14 continued)

The data sources and calculations for each column of the data table over the page are:

1. *PD Survey Table A.0* Aid reported in the 2006 Survey.
2. *PD Survey Table A.9* Budget support as % of total aid reported.
3. % of total aid reported that is not budget support.
4. *PD Survey Table A.3* Aid disbursed by donors for government sector.
5. *PD Survey Table A.3* Baseline ratio of aid disbursed by donors included in government budget estimates.
   5(i). Budget support as % of aid disbursed for government sector.
   5(ii). Proportion of baseline ratio (col.5) that is not budget support.
6. % of non budget support aid for government sector (calculated from *PD Survey Table A.3* Aid disbursed minus *PD Survey Table A.9* Budget support) that is on budget (calculated from *PD Survey Table A.3* Aid on budget minus *PD Survey Table A 9* Budget support).

Box 15: PFM quality vs. use of PFM systems

	Paris Declaration Monitoring (2005 data)		CPIA
	Indicator 5a: % aid flows using country PFM	**Rank on Indicator 5a**	**Indicator 13 (2006) [PFM quality]**
Averages	**40%**		**3.20**
Tanzania	66%	1	4.50
Ghana	62%	2	4.00
Uganda	60%	3	4.00
Bangladesh	53%	4	3.00
Kenya	47%	5	3.50
Ethiopia	45%	6=	4.00
Burkina Faso	45%	6=	4.00
Nicaragua	44%	8	4.00
Rwanda	39%	9	4.00
Mozambique	36%	10	3.50
Vietnam	32%	11	4.00
Mali	29%	12	3.50
Bolivia	26%	13	3.50
Senegal	23%	14	3.50

Source: Selected data from Box 11 above.

Recommendations for monitoring aid on budget

4.20 Measuring the extent of aid using country systems at the various dimensions of "on budget" is complex. Recommendations for joint action by government and their aid partners are to strengthen the monitoring of the Paris Declaration commitments by:

- setting standardised and less flexible definitions at international level;
- monitoring the proportion of project aid that is on budget;
- continuing the country-level focus on use of government systems, and setting country-level targets for progress.

Box 16: Selected available PEFA scores in rank order

The PEFA framework rates PFM performance in participating countries using a total of 28 PFM indicators, Ratings for each of these indicators are made using an A to D scale ranking, where A is the highest score and D is the lowest. The Aid On Budget case study countries are highlighted, and analysis behind the scores is included in the case study reports.

The PEFA diagnostic is not designed to produce international league tables on PFM. Therefore it is important not to read too much into these rankings. However, it is interesting that:

- For most of the indicators there is a spread of scores among the case studies, and the rankings are significantly different for different indicators. This suggests some useful variety in the case study sample.
- For indicators D-2 and D-3 (donor performance on providing information and using national procedures), scores for *all* the study countries are in the lower half of the range. (The same is true of Indicator PI-28 – legislative scrutiny of external audit.)

PI-5 Classification of the Budget		
Burkina Faso	(Apr-07)	A
Ethiopia	(07)	A
Rwanda	(Sep-07)	A
Ukraine	(Mar-07)	A
Ghana	(Jun-06)	B
Mozambique	(Mar-06)	B
Uganda	(Jul-06)	B
Afghanistan	(Dec-05)	C+
Zambia	(Dec-05)	C+
Bangladesh	(Jul-07)	C
Kenya	(Jul-06)	C
Kyrgyz Republic	(Jan-06)	C
Mali	(Mar-07)	C
Moldova	Jun-06	C
Tanzania	(Jun-06)	C

PI-6 Comprehensiveness of information included in budget documentation		
Burkina Faso	(Apr-07)	A
Moldova	(Jun-06)	A
Tanzania	(Jun-06)	A
Ukraine	(Mar-07)	A
Ethiopia	(07)	B
Kenya	(Jul-06)	B
Kyrgyz Republic	(Jan-06)	B
Mozambique	(Mar-06)	B
Uganda	(Jul-06)	B
Zambia	(Dec-05)	B
Afghanistan	(Dec-05)	C
Bangladesh	(Jul-07)	C
Ghana	(Jun-06)	C
Mali	(Mar-07)	C
Rwanda	(Sep-07)	D

PI-7 Extent of unreported government operations		
Ghana	(Jun-06)	A
Burkina Faso	(Apr-07)	B+
Moldova	(Jun-06)	B+
Afghanistan	(Dec-05)	B
Rwanda	(Sep-07)	B
Tanzania	(Jun-06)	B
Mali	(Mar-07)	C+
Mozambique	(Mar-06)	C+
Kenya	(Jul-06)	C
Uganda	(Jul-06)	C
Ethiopia	(07)	D+
Ukraine	(Mar-07)	D+
Zambia	(Dec-05)	D+
Bangladesh	(Jul-07)	D
Kyrgyz Republic	(Jan-06)	no score

PI-27 Legislative scrutiny of the annual budget law		
Burkina Faso	(Apr-07)	B+
Mali	(Mar-07)	B+
Moldova	(Jun-06)	B+
Mozambique	(Mar-06)	B+
Ukraine	(Mar-07)	B+
Ghana	(Jun-06)	C+
Rwanda	(Sep-07)	C+
Tanzania	(Jun-06)	C+
Uganda	(Jul-06)	C+
Zambia	(Dec-05)	C+
Ethiopia	(07)	D+
Kenya	(Jul-06)	D+
Kyrgyz Republic	(Jan-06)	D+
Afghanistan	(Dec-05)	D
Bangladesh	(Jul-07)	D

PI-28 Legislative scrutiny of the external audit reports		
Burkina Faso	(Apr-07)	C+
Ethiopia	(07)	C+
Ghana	(Jun-06)	C+
Mozambique	(Mar-06)	C+
Zambia	(Dec-05)	C+
Bangladesh	(Jul-07)	C
Tanzania	(Jun-06)	C
Kenya	(Jul-06)	D+
Moldova	(Jun-06)	D+
Rwanda	(Sep-07)	D+
Uganda	(Jul-06)	D+
Ukraine	(Mar-07)	D+
Afghanistan	(Dec-05)	D
Kyrgyz Republic	(Jan-06)	D
Mali	(Mar-07)	D

D-1 Predictability of Direct Budget Support		
Afghanistan	(Dec-05)	A
Burkina Faso	(Apr-07)	A
Tanzania	(Jun-06)	A
Rwanda	(Sep-07)	B+
Bangladesh	(Jul-07)	B
Ghana	(Jun-06)	C+
Kyrgyz Republic	(Jan-06)	C+
Mozambique	(Mar-06)	C+
Uganda	(Jul-06)	C+
Ethiopia	(07)	C
Mali	(Mar-07)	D
Kenya	(Jul-06)	D
Zambia	(Dec-05)	D
Moldova	(Jun-06)	no score
Ukraine	(Mar-07)	no score

D-2 Financial information provided by donors for budgeting and reporting on project and programme aid		
Burkina Faso	(Apr-07)	C+
Bangladesh	(Jul-07)	C
Ethiopia	(07)	C
Ghana	(Jun-06)	C
Tanzania	(Jun-06)	C
Afghanistan	(Dec-05)	D+
Mali	(Mar-07)	D+
Mozambique	(Mar-06)	D+
Uganda	(Jul-06)	D+
Zambia	(Dec-05)	D+
Kenya	(Jul-06)	D
Moldova	(Jun-06)	D
Rwanda	(Sep-07)	D
Ukraine	(Mar-07)	D
Kyrgyz Republic	(Jan-06)	no score

D-3 Proportion of aid that is managed by use of national procedures		
Bangladesh	(Jul-07)	B
Burkina Faso	(Apr-07)	C
Tanzania	(Jun-06)	C
Uganda	(Jul-06)	C
Afghanistan	(Dec-05)	D
Ghana	(Jun-06)	D
Kenya	(Jul-06)	D
Mali	(Mar-07)	D
Moldova	(Jun-06)	D
Mozambique	(Mar-06)	D
Rwanda	(Sep-07)	D
Ukraine	(Mar-07)	D
Zambia	(Dec-05)	D
Ethiopia	(07)	no score
Kyrgyz Republic	(Jan-06)	no score

Source: Individual country PEFA assessments.
Notes: Afghanistan scores have been translated to the A-D ranking from the original 1-4 ranking used.

5. APPROACH TO THE CASE STUDIES

This chapter highlights the different perspectives of different agencies and stakeholders. It emphasises the importance of incentives to provide and use information, and the likely importance of country context. The country cases were chosen to illustrate a range of such contexts.

Introduction

5.1 This chapter describes the study's approach to the case studies from two angles. First it provides a brief overview of the perspectives and incentives on both sides of the aid relationship, since these are likely to influence whether and how country budget systems are used. The case studies are an exploration of how these factors interact in a particular country context. The second part of the chapter explains the rationale for the choice of case study countries, and the study's emphasis on the quality of aid capture.

Stakeholder perspectives and incentives for aid capture

5.2 The capture of aid in government budgets requires action both by governments and by donors. Technical features of the budget process are relevant, but effective aid capture depends fundamentally on the perspectives of different actors and the incentives that motivate them.

Donor perspectives and incentives

Influence of aid instrument characteristics

5.3 Aid instrument characteristics have a strong influence on whether they are likely to be captured in budget documents and budget processes. Budget support is captured (at least in most dimensions) by definition.[26] Loans are more likely to be captured than grants, because of associated legal procedures and the need to anticipate debt service. Technical assistance and other forms of aid-in-kind are less likely to be captured (especially emergency aid which is less likely to follow the budget cycle). And aid that is disbursed through non-government partners or to sub-national levels of government is also less likely to be captured than aid to the central government.

Influence of aid agency characteristics

5.4 Aid agencies have different mandates and report to different constituencies, and they operate with differing degrees of flexibility at country level. All these factors may constrain the aid instruments they use, Further, they have different perspectives on aid and different attitudes to risk, including the fiduciary risks associated with using government systems. Although the whole spectrum of aid agencies (along with partner governments) signed up to the Paris Declaration, there are significant differences in how it is interpreted. These different interpretations are explored in the Literature Review and briefly illustrated in Box 17 below.

[26] However, this study found examples where budget support was not made clearly visible in budget documents as a source of finance. Late notification and unpredictable disbursement may also make it difficult to capture budget support on plan.

Box 17: Sharing information and using government systems

Among the donors the differences in approaches to putting aid on budget can be plotted along a spectrum. At the one end there are donors that advocate supplying information on aid flows to the partner country so that it is 'reported on' budget. At the other end there are donors that advocate ensuring aid is 'integrated on' budget, with country systems used at each stage of the budget cycle.

An example of the first approach is set out by the Millennium Challenge Corporation (MCC). The MCC guidelines for fiscal transparency lay out requirements for reflection without requiring the use of country systems:

> "MCC will require that, wherever possible, MCC Program activities are reflected in budget documents of the recipient country. … Reflecting the activity in budget documents does not necessarily mean that MCC resources are managed by existing public expenditure systems." (Millennium Challenge Corporation, 2006: 5)

An example at the other end of the spectrum is Sida. Sida's interpretation of the Paris Declaration commitment to put aid on budget is:

> "In line with the Paris Declaration, Sida shall align to the maximum extent possible with national systems." (Sida, 2007: 27)

Reporting aid on budget and integrating aid on budget are not mutually exclusive activities but they are not substitutes either. Reporting aid on budget is a different activity from integration of aid on budget and reporting will not necessarily result in the same benefits as can be achieved from integration.

Differing interests and incentives within aid agencies and governments

5.5 The interests of staff working for aid agencies (as with most organisations) may pull in different directions. Headquarters' attitudes to risks and the use of country systems may differ from the perspective of staff based in-country. Generalists' priorities and preferences may differ from those of sector specialists. How these potential tensions affect the agency's use of country systems will depend on procedures as well as policies, and, not least, on the personal incentives facing their staff. For example, a gap between policy and practice may emerge if there is an inconsistency between the policy and the short-term career incentives that motivate staff.

5.6 A similar pattern of conflicting interests and tensions applies on the government side. For example, finance ministries and sector ministries are likely to have a different perspective on the merits of funds channelled directly to sectors; central and local government bodies may have a similar divergence; project management units have an interest in perpetuating parallel systems. Box 18 illustrates the interplay between incentives on both donor and government sides.

Box 18: Interlocking incentives in traditional aid

Incentives are to be found within both donor agencies and recipient governments that help to maintain and reproduce the vicious circles associated with limited country ownership of development efforts. Case studies of sectors in Mozambique, Tanzania and Uganda suggest the importance of the following:

- Within recipient governments, project modalities with parallel funding and management mechanisms generate multiple material and non-material benefits for the ministers and civil servants in whose sectors they are located, including salary top-ups, allowances, vehicles, training and travel opportunities, and prestige. Ministers, parliamentarians and local authorities are interested in the political credit they get for attracting a stand-alone project to a specific sector or area. The resource flows from a free-standing project are visible, reliable and relatively simple to control. The government officials at the sector or local-government prefer to avoid the unpredictability, rigidities and reporting requirements associated with funding through the national budget, and the reduced control this implies. In addition, dealing with a single donor is simpler than dealing with several through a pooled-funding or budget support arrangement, where donors tend to "gang up" on the ministry in way that reduce its discretion.
- Donor agencies, on the other hand, benefit from the visibility associated with separately managed and "branded" projects. They assist in defending the aid budget to their own parliamentary committees and audit authorities, and in defending the departmental budget within the agencies. In some agencies, it is still the case that staff promotion prospects are enhanced when a particular large project can be presented as the work of an individual or small team. In contrast, where more programmatic, multi-donor ventures are introduced, visibility is lost and the attribution of development results to the particular donor's support becomes problematic. This concern is especially pronounced when donor agencies are heavily concentrated in a particular field or when a donor is small relative to others in a field. Donor risk-aversion also favours free-standing projects. A standard assumption, which is not always borne out in practice, is that projects can be tightly managed, whereas using government systems to manage projects or programme calls for a "leap of faith".

Source: Williamson and Kizilbash Agha, 2008 (reproduced from Booth et al, 2008).

Effects on incentives for putting aid on budget

5.7 The case studies prepared for this report illustrate some of these problems with bringing aid on budget originating from the conflict of interests and incentives that often exists within aid recipient governments. For example, the Mozambique case study reports how efforts to put aid on budget in that country have been hampered by government agencies' (e.g. line ministries, provincial governments, districts) fear that reporting on budget all the aid they receive will reduce the amount of funding they obtain from the state budget. In other words, a concern that, as the true amount of total funding they manage becomes apparent, the Ministry of Finance might be tempted to reduce budget funding for these projects in the same amount as the aid they receive from donors. Box 19 describes similar perverse incentives in Ethiopia and Uganda arising from explicit attempts to factor aid into overall resource allocations; it also illustrates perverse incentives that can arise from the way budget deficit targets are defined.

5.8 This Mozambique country study also reports on how ongoing tensions between the two main Mozambican political parties, Frelimo and Renamo, hamper the quality and extent of parliamentary debates regarding the budget, including issues regarding aid funding of the budget. As discussed in Chapter 6 below, the political framework was found to be similarly important in many of the countries studied.

Box 19: Examples of perverse incentives

Ceilings and Offset

Both MDAs and aid agencies have an incentive not to report aid (fully) if they fear reporting will lead to a reduction in the allocation of domestic finances. This problem has been experienced in Ethiopia where grants to sub-national governments are adjusted to offset aid that flows directly to the sub-national level. More recently Uganda decided that off-budget aid should be included in MTEF ceilings, and experienced a similar problem of under-reporting. (The extent of under-reporting was revealed by a separate stock-taking of donor aid programmes. This highlights the importance of triangulating information when there may be perverse incentives.)

Previously the incentive in Uganda worked in the opposite direction: MDAs would exaggerate likely aid flows in order to maximise the allocation of counterpart funds.

Deficit Targets

The (unintended) distortions generated by the domestic primary deficit target previously included in the IMF's macroeconomic and fiscal support program to Mozambique are an interesting example of how differences in development agencies' mandates can undermine the process of bringing aid on budget (see Mozambique country study). This indicator, which is typically used to monitor fiscal discipline and sustainability, in the past hindered efforts to increase aid capture on budget by creating incentives to underreport and misclassify aid to the government. There seem to have been two main dynamics:

(a) Firstly, increases in aid tended to increase the value of the domestic primary fiscal balance, unless these funds were entirely devoted to investment. This gave the government a strong incentive to keep off budget any unexpected surge in externally funded spending that was not already factored into the IMF's domestic primary fiscal deficit target.

(b) Secondly, the primary deficit target created strong incentives to misclassify budget spending, reporting as investment expenditure the full value of donor-funded projects, even when a significant proportion of these funds were actually funding recurrent spending.

The IMF has since revised its approach to macroeconomic targets to avoid these particular perverse incentives.

Conclusion

5.9 Technical and legislative solutions will not work if they are not sufficiently aligned with the interests of those involved. The complexity of the systems being investigated – the number of interacting factors and interests across many different phases of the planning and budget cycle – makes it likely that general principles will need to be customised to particular country contexts.

The case studies

Choice of case study countries

5.10 Case studies were undertaken in ten SSA countries: Burkina Faso, Ethiopia, Ghana, Kenya, Mali, Mozambique, Rwanda, South Africa, Tanzania and Uganda. A factual analysis was conducted in all of them, with more in-depth studies in five of the countries: Ghana, Mali, Mozambique, Rwanda and Uganda.

5.11 There is a good range of countries included, both overall, and among the countries where more in-depth studies were carried out. The countries are from different geographical locations: Central Africa (Rwanda), East Africa (Ethiopia, Kenya, Tanzania and Uganda), Southern Africa (Mozambique and South Africa) and West Africa (Burkina Faso, Ghana and Mali). The countries have distinct administrative and linguistic inheritances, with the group including francophone and lusophone in addition to the anglophone countries. There is also a range of experiences of federalism and decentralisation. At one end of the spectrum, Ethiopia is a federal state with devolved regional and district governments. The other countries covered include unitary states that have implemented decentralisation to varying degrees; in several, further decentralisation is under way.

Box 20: ODA – basic data for the case study countries

	average 2003–05		
	ODA * (USD m)	**Aid / GNI (%)**	**Aid per capita (USD)**
South Africa	694.7	0.3%	15.2
Kenya	812.7	4.0%	24.3
Burkina Faso	653.0	12.6%	51.0
Ghana	1,696.2	13.0%	78.3
Mali	715.0	13.1%	54.6
Tanzania	1,017.1	14.9%	27.1
Uganda	1,256.3	15.9%	45.1
Ethiopia	1,890.5	18.8%	27.0
Mozambique	1,251.8	21.9%	64.4
Rwanda	502.6	25.9%	56.5

Note: Countries in **bold** are those for which free-standing country studies have been prepared.

* ODA = total grants disbursed and loans extended

Source: OECD DAC international development assistance statistics (DAC Online, OECD.Stat.).

5.12 Importantly for this aid on budget study, the countries provide a spectrum of experience across the following dimensions in the area of development assistance:

- *Ratio of aid to gross national income* (see Box 20): South Africa has the lowest ratio of aid to gross national income (0.3%). The others are all significantly aid dependent countries with eight of the ten countries averaging aid over 10% of GNI (only South Africa and Kenya record ratios below 10%). Mozambique and Rwanda are the most aid dependent (ratios of 22% and 26% respectively).
- *Configurations of donors*: different donors are active in different countries, although the World Bank and the EC tend to be among the large disbursers for most of the countries. All countries are recipients of aid from both bilateral and multilateral agencies. Some of the countries have very congested aid environments (for example, around 40 donors are active in both Mozambique and Uganda).
- *Types of aid modalities in use*: countries have individual experiences of what share of ODA is provided through different aid modalities. At the same time there are some shared trends. In most of the countries most ODA is provided in the form of grants (for example, 84% of ODA in Rwanda, 75% in Kenya and 73% in Tanzania) while in South Africa as a matter of policy by the government all ODA to the general government sector is in the form of cash grants and technical assistance support. Another trend is the increasing use of budget support. Again with South Africa the exception, in all the other case study countries budget support has become an

important aid modality in recent years. For example, general budget support was 26% of ODA in 2005 in Burkina Faso, 33% in Mali and 34% in Ghana.

- *Level of progress on aid management institutions and alignment and harmonisation agendas*: there are some (general) similarities among the countries in the embracement of the HIPC and PRSP approaches. All have reached HIPC completion point and most are on at least their second generation PRSP with the exceptions of: Kenya, which did not meet the HIPC indebtedness threshold but has introduced a PRSP as a condition for access to new concessional lending from the IMF and the World Bank, and South Africa, which is not a highly indebted country and has not prepared a PRSP. Similarly all the countries are involved in progressing alignment and harmonisation agendas, and as part of this all ten countries are taking part in the monitoring of progress on the Paris Declaration indicators (see Paris Declaration Monitoring Survey 2006 (OECD, 2007a) and forthcoming Survey 2008). The detailed case study countries also include several where concerted efforts to bring aid on budget offer scope for learning (for example, Mozambique where several donors created in 2005 a specific on-budget taskforce and Uganda where in 2006 a Division of Labour Exercise was launched with the aim, inter alia, of improving the alignment of donor engagement to the implementation of the Poverty Eradication Action Plan).
- All the countries have ongoing *PFM reform programmes,* but with a range of different emphases and starting points.

Case study approach

5.13 The case studies did not involve a new quantitative survey. In each country, researchers assembled the best available information from existing sources and focused especially on trying to explain the patterns of aid capture that were found. The researchers were all already familiar with the countries concerned, and they were assisted by the involvement of the Senior Budget Officers linked to CABRI and of key donor representatives.

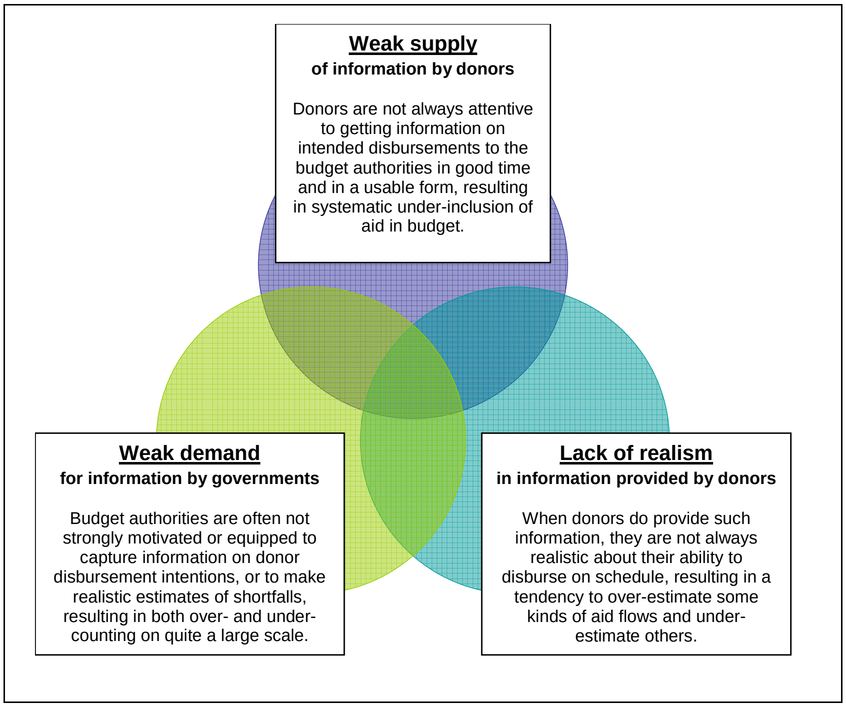
5.14 Researchers investigated the technical factors involved (notably the characteristics and the quality of public finance management systems) but also explored the interests and incentives involved on both sides of the aid relationship (in line with the discussion at eh beginning of this chapter). Researchers considered the different dimensions or phases of aid on budget (Chapter 2, Box 3), and for each phase tried to assess the quality of aid capture. They adopted the perspective that "putting aid on budget is the joint effect of donor and government practices, and where there is poor quality of aid capture, this is the compound effect of both donor and government shortcomings"(Literature Review: ¶51). Moreover, whether information is successfully captured depends on the demand for information as well as on the technical capacity to supply it.

5.15 The simultaneous attention to demand and supply, quality and incentives is illustrated in Box 21. It was also reflected in the reporting format adopted. For all ten countries, researchers prepared summary reports in a matrix format which, for each dimension of aid capture, considered:

(a) the evidence of capture (what is captured?)
(b) the quality of capture (how well? how useful?)
(c) explanations (why/why not?).

The resulting case study matrices are presented in full as Annex B to this report.

Box 21: Factors behind quality of aid capture in the budget



Source: Mokoro, based on OECD, 2007a.

5.16 As criteria of quality, researchers were asked to consider:

- the technical quality of information provided (its completeness, credibility, disaggregation and detail, etc);
- timeliness and accessibility (who has the information, and at what stage in the relevant process);
- whether and how information was actually used (does the information influence decisions and choices? is there feedback to providers and does this influence future budget rounds?)

5.17 It was expected that the ability to make good use of information about aid would largely depend on the quality of the information and processes relating to non-aid resources.

6. LESSONS FROM THE CASE STUDIES

This chapter highlights findings from the case studies researched for this report. The principal findings from all ten African case studies are summarised in Annex B, and separate reports have been published on five of the case studies. This chapter therefore focuses on the key findings that have wider relevance.

Introduction

6.1 Experience of putting aid on budget in ten African countries was specially researched for this report. This chapter highlights key findings that seemed especially relevant to the identification of future good practice. Findings are discussed under the headings of each dimension of aid capture. However, this is simply a presentational convenience. As the findings themselves will illustrate, there are many overlaps and interactions between the different dimensions. We consider first the practical relevance of each dimension, then note the main factors that influence the capture of aid; finally we highlight good (and bad) practices identified. This is followed by a cross-cutting discussion of decentralisation.

Putting aid on plan

The relevance of putting aid on plan

6.2 Good practice calls for annual budgets to be guided by medium-term strategies. Where aid is a significant proportion of resources, it clearly needs to be factored into the government's medium-term plans. Being able to anticipate the aid that will augment or substitute for domestic budgetary resources in the coming budget year is a minimum requirement. Planners also need to take a view on the availability of aid and other resources over a much more extended horizon. The information requirements for the short and the medium term, and for different modalities, are different. Aid needs to be included (broadly) on the resource side, even if it can't be allocated (specifically) on the expenditure side. As the Uganda country report notes: "in the [PRSP] and strategic plans, the capture of aid in very general terms is largely appropriate. Project aid in the overall MTEF, which is presented by sector, is helpful in facilitating high level inter and intra-sectoral decision making, whilst budget support is appropriately captured as a revenue only."

6.3 Factoring aid into the planning process should influence the choices of both governments and donors. The Rwanda country report highlights the difference between a data-collection exercise and a true planning exercise. The South Africa researcher noted a tendency for information about government plans to inform aid choices "rather than the reciprocal using of aid information to inform budgeting choices".

Factors influencing aid on plan

Quality of government planning process

6.4 To bring aid on plan in a meaningful way depends on the government itself having a meaningful planning system. Key elements of effective planning include a transparent planning process with a clear calendar, realistic costing of alternatives, and, ideally, a Medium Term Expenditure Framework (MTEF) that sets annual budgets within a longer perspective. If there is not a credible government planning process, it is difficult to make systematic use of information that donors provide. For donors, it is easy to "align" with objectives that lack the discipline of prioritisation. In practice, the case study countries exhibit varying degrees of sophistication and discipline in their planning; MTEFs are at varying stages of development, and the quality of the plan–budget link may vary a lot between sectors.

6.5 Quality of capture also depends on the capacity to use the available information. This is a matter of systems as well as the ability of the people who staff them. A clear budget calendar is an obvious system element, since the timing of information greatly affects its utility. It is also important to have strong sector planning processes.

PRSPs and sector approaches

6.6 A general finding is that PRSPs have strengthened the common focus of government and donors, although PRSPs vary in their quality as planning documents. There are continuing efforts to link PRSPs to more disciplined MTEFs. Sector approaches have helped to strengthen sector planning and the focus on capturing aid at sector level. Indeed, aid is integrated successfully only when it is integrated well at sector level. Coordination belongs at central level, but integration occurs at sector level. If sector-level processes are weak, the capture of aid on plan and subsequently on budget will be ineffective.

6.7 Hence, sector approaches and sector working groups can be very important. Their role was highlighted, for example, in the case studies for, Mozambique, Rwanda, Tanzania and Uganda. However, not all such working groups were effective in including donor projects in sector planning and budgeting. In some cases their focus was exclusively on policy, or they lacked effective participation from the government or from key donors. Donors that did participate did not always provide useful information about their programmes. On the positive side, sector-wide approaches (SWAps) were often found to have developed and supported technical analysis capacity as well as contributing to dialogue and the flow of information for planning purposes. It is a challenge to ensure that sector processes (including Public Expenditure Reviews – PERs – in Uganda, Tanzania and Kenya) are equally owned by government and donors; and that sector processes are fully articulated with overall plan and budget (Uganda is a strong example of such articulation).

Bringing different modalities on plan

6.8 As with other dimensions there is a hierarchy among aid modalities in their likelihood of being captured on plan:

(a) In principle, general budget support (GBS) is fully integrated with domestic resources. In practice, even for GBS, the quality of capture on plan may be undermined by unpredictability. At the same time, budget support helps drive the capture of other modalities: the dialogue around GBS creates a demand for coherent medium-term planning documents, and also reinforces efforts to strengthen PFM generally (thereby influencing all modalities and dimensions).

(b) As already noted, sector approaches often mean that planning for the sector is more systematic. Like GBS, they provide a focus for government–donor dialogue that can improve the quality of planning. Sector budget support and pooled funds are usually very visible for planning purposes (though some pooled funds have followed parallel planning processes and, as discussed later, pooled funds may be off-budget in many dimensions).

(c) Projects are more likely to be on plan if financed by loans than if financed by grants. Projects themselves take many forms. The planning (and financial) implications of large-scale infrastructure projects are quite different from smaller and more adaptable interventions. Separate "investment plans" and "development budgets" are traditional devices for bringing projects on plan and on budget, but may cause problems in disconnecting aid from domestic resources (see further discussion below, especially Box 27).

(d) The forms of aid least likely to be captured on plan are technical assistance and other in-kind aid (some in-kind aid is emergency in nature and therefore difficult to plan for in detail), and aid that is disbursed via non-government bodies. Aid provided directly to decentralised levels of government is also harder to capture.

The paradox of aid agency projections

6.9 There are systematic biases in the information provided by aid donors. They are very cautious about providing aid forecasts that are not based on firm commitments. This leads to a paradox. Donor projections of disbursements within the budget year tend to be too optimistic (because donors rarely meet their commitments in full[27]). At the same time, donor projections of aid over the medium term tend to be too pessimistic, because donors are unwilling to make projections above what they have formally committed to, even when they know that new projects and programmes are likely to appear. Box 22 uses Uganda to illustrate this problem.

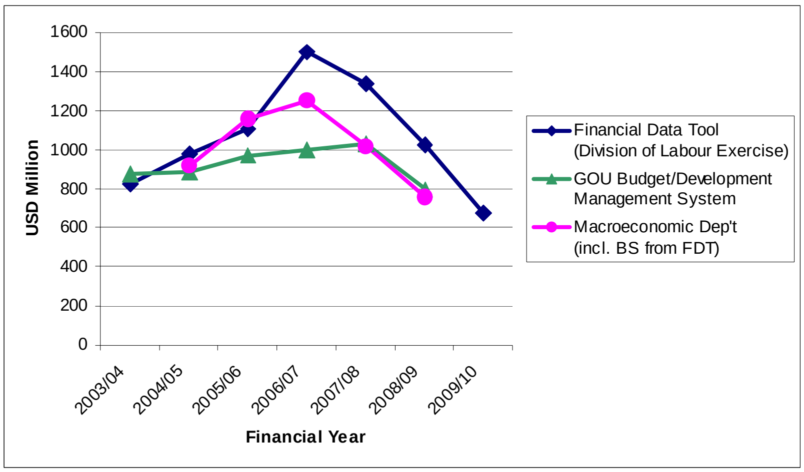
[27] Even if committed funds are fully available, expenditure may fall short, especially if funds arrive late in the budget year.

Box 22: Paradoxical aid projections (Uganda illustration)

Donor aid projections typically overestimate short-term disbursements and underestimate medium-term aid flows. This paradox is well illustrated in Uganda. The Uganda case study notes:

Quality of Aid Data: Aid data provided by donors is largely based on financial commitments, and donors are either unwilling or unable to provide medium term estimates of aid other than what has been committed. This provides two problems. Firstly that aid data provided by sectors and by donor agencies for the budget year are usually fairly comprehensive, but over-optimistic – i.e. in aggregate not all donor commitments are realised. Secondly aid projections for the outer years usually underestimate future levels of aid, as existing commitments tail off over the medium term. The diagram below shows data compiled under the Division of Labour Exercise and the (undiscounted) Macroeconomic Department data compiled directly from donors. Both show a significant tailing off of aid over the medium term (2006/07 was the budget year).

Comparison of Aid Projections at the time of Uganda's 2006/07 Budget



At the aggregate level, for the purpose of macroeconomic management the Ministry of Finance tries to make realistic projections of aid, by discounting aid for the budget year in question (different discounts are used for budget support and projects), and making realistic projections of budget support (i.e. projecting it above committed levels) over the medium term. The latter is an inexact science, especially because of the lack of realism in aid data from donors and sectors.

Meanwhile the allocations which appear in the Annual Budget – the Estimates of Revenue and Expenditure – are based on annual donor commitments, rather than the discounted numbers which appear in the Macroeconomic Framework and MTEF. This is because it is difficult to predict which individual project or programme is likely to under-perform.

Source: Aid On Budget Uganda Case Study (diagram reproduced from ODI: 2007).

Good practice considerations

Progress in strategic budgeting

6.10 The government's own progress in strategic budgeting is a key factor in bringing aid on plan. Although long-term planning has to address trade-offs between sectors, useful progress can be made at the sector level. Government leadership of the process is crucial. The principles of strategic budgeting are general, but where aid is prominent, it is important:

- not to take donor information at face value, but to use it as the basis for scenario planning (see Box 23);
- to engage donors with a government-led planning process (Box 24).

Box 23: Putting aid on plan: realistic projections and scenario planning

A number of governments have recognised the biases and uncertainties in donor projections of their own aid flows (see Box 22), and respond by discounting estimates of short-term disbursements, and developing their own alternative scenarios of aid flows in the medium- and long-term.

Discounted budget estimates

The Rwanda study provides a good example and rationale for discounting:

> Because some projects have a poor record of project execution and in the past the Development Budget tended to be often 'under-executed', expected project disbursements are discounted (at variable rates) in the budget preparation process by the Budget Department. Amounts included in the Development Budget are therefore often lower than the disbursement estimates provided by project coordinators (who, for opposite reasons, have shown in the past a tendency to over-estimate expected disbursements).

Uganda has used discounted estimates of budget support disbursements, based on experience, to avoid authorising unfunded expenditures. Ghana also applies discounts.

Scenario planning

Several countries have published different funding scenarios for their PRSPs/medium term expenditure plans. Ethiopia describes different expenditure scenarios for different levels of donor funding. Mozambique's most recent PRSP is based on three expenditure scenarios. Because of the unpredictability of its budget support, Kenya does not include budget support in its main budget but only in an alternative scenario expenditure plan. In Tanzania, government and donors are working towards the joint definition of alternative scenarios.

Box 24: Engaging donors in medium-term planning

Medium-term planning processes in Uganda, Tanzania and, recently, Kenya, seek to engage donors transparently in analysis and review linked to planning and budgeting. In Tanzania, for example:

> The planning and budgeting process structures require the participation of donors and other stakeholders in sector and thematic working groups. The wide use of sector SWAps supports the inclusion of aid in a more meaningful way on plan. The quality varies across sectors depending on how well structures work and the analytical capacity in the sector.

A positive element in Uganda is the transparency of the process and the availability of sector and national budget framework papers to stakeholders in sector working groups and across government. Kenya also publishes all sector and national framework papers.

In all three countries, efforts are made to fit systematic public expenditure reviews into the planning and budgeting calendar.

The Multi Donor Budget Support (MDBS) process in Ghana is another example of effective engagement between the government and donors (and a government-led process).

Engagement in such processes makes it more likely that information (in both directions) will be provided, queried and used.

Drawbacks of fragmented planning and budgeting systems

6.11 Separate development budgets can be seen as a device for keeping aid on plan and on budget while deferring to aid agency desires for their funds to be separately identified. Over time, however, "investment budgets" often degenerated into "aid budgets"; so that aid would appear in the development budget even if it was financing recurrent costs. The disadvantages of dual budgeting were exacerbated when responsibilities for development and recurrent budgets were divided between separate planning and finance ministries. In many countries, some of the disadvantages of dual budgeting persist, but there is scope to mitigate them by adopting more integrated budget classifications, documents and processes. For example in Rwanda, the recurrent/capital split is being mitigated by new chart of accounts, and showing all ministry expenditure by ministry instead of in a separate Development Budget. (See also Box 27 below.)

Putting aid on budget

The relevance of putting aid on budget

6.12 Annual budgets are a universal management tool. The formal budget document is the basis of legislative authority for expenditure, and subsequently the basis for control of budget disbursement and the monitoring of budget implementation. However, there may be deviations between a formally approved budget and what happens subsequently. The budget documents are only a starting point in discovering whether, and how well, aid is incorporated in the formulation, authorisation and implementation of government budgets.

6.13 Budgets should show the sources of finance for public spending as well as the details of expenditure. Both aspects are important in giving the legislature a full picture of the expenditure choices it is being asked to endorse. As noted in the discussion of bringing aid on plan, it is important to factor available aid resources into strategic planning at an early stage – before their detailed uses have been determined. In an annual budget document, the extent to which uses are specified will depend largely on the aid modality. Earmarked project funding may be tracked to specific expenditure items in the budget, while general budget support is treated in the same way as most domestic revenue (i.e. it is not tagged to specific expenditure items, but underpins the budget as a whole).

Factors influencing aid on budget

Incentives and disincentives for including aid on budget

6.14 On the donor side, the most common deterrents to putting aid on budget are the overall credibility of the budget, and the specific visibility of donor funds within it. *Credibility* is undermined by deviations between budgets and actual outturns (see Box 25). The desire for *visibility* has a fiduciary aspect (as a means to show that funds have been used as agreed), but may also relate to an agency's broader need to be able to demonstrate results – that its aid has made a difference. Thus, government classifications which make it hard to identify different uses and different donors tend to discourage aid from coming on budget.

Box 25: Deviations between budgets and actual spending

Credibility of budgets is recognised as a key criterion of effective public finance management (reflected in the first four PEFA indicators – see Chapter 3, Box 6). In several of the case study countries, large deviations between approved budgets and actual outturns have undermined donor confidence and provided a rationale for not putting aid on budget.

Budget discrepancies may occur in different ways:

- Cash may fall short, with the result that budgeted funds are not released. This is common in countries that have cash rationing systems, sometimes necessitated by macro-economic instability, but often because fiscal forecasting is not reliable.
- The initially approved budget may be radically revised during implementation. Expenditure demand in some areas may be more than budgeted, resulting in funds being deviated from a budgeted area of spending to areas that experience shortfalls. The demand may be more on account of lack of discipline in budget execution, when activities are undertaken which were not in the plan, although they are not authorised by the budget and are not unforeseen or unavoidable. It may also be on account of changes in the external environment, such as natural disasters or other emergencies. Often however, it is because budgeting itself did not estimate properly what the cost of programmes will be, or because changes to key cost drivers (such as salaries) take place out of step with the budget process.
- Some discrepancies may reflect the ways aid is managed. Budgeted aid funds may not arrive (with consequences for domestic counterpart funds as well), or government may fail to meet trigger conditions for their disbursement. Aid expenditures via Channels 2 and 3 may be under-recorded if aid agencies or project implementation units do not supply expenditure data on time and in compatible formats.

6.15 On the government side, there were differences among case study countries in their attitude towards incorporating aid on budget. Some proactive governments (e.g. Rwanda) take the view that aid should appear in the national budget only if there is meaningful national discretion as to how it is used. Others (e.g. Ethiopia) have legislation which requires them to show all aid in the budget, even if it does not pass through government disbursement procedures. (And, as already noted in Chapter 5, MDAs may have an interest in protecting their discretion by keeping off the budget aid that their sectors receive directly.)

6.16 On the government side too, there are concerns about credibility (will promised donor funds arrive?) and practical concerns about compatibility of information systems (is donor information provided on time? and in a format compatible with the government budget – e.g. in terms of detailed classification and time period?). Looking further ahead, will information for the ex ante budget be matched by timely information on actual expenditures?

6.17 In many cases it was clear that, while efforts to include aid could be quite onerous for both parties, the failure to include aid on budget did not have significant consequences for those directly involved. For example, there were cases where donor officials never checked whether their aid appeared in government budgets or not, implying that its inclusion in the budget or not made no practical difference to them.

Approaches to different aid modalities

6.18 Different aid modalities tend to be treated differently, in terms of efforts to incorporate them on budget. Loans and credits are likely to be incorporated, because of the need to budget for debt service, as well as legal stipulations. Budget support inherently has to be incorporated (though there are striking differences in the quality of information provided about budget support as a source of funds; in one case – Mali – it was not explicitly noted in the ex ante budget). In some countries (Ghana, Mali) being off budget is taken as an inherent characteristic of projects. In Mali's case this is partly a reflection of a francophone tradition that, in effect, excludes from the main budget any expenditure that is not also on treasury. Such restrictive assumptions are unhelpful since they preclude active consideration of how project aid might be brought on budget, and may simultaneously result in very restrictive interpretations of sector budget support (see Box 26).

Box 26: "Sector Budget Support" in Mali

One of the characteristics of budget support, according to the standard definitions (see Chapter 2), is that it is not linked to specific project activities.

However, this does not apply to the modality known as "sector budget support" in Mali. As described in the Mali case study:

> The recent increase in sectoral budget support has come about with the switch from pooled funding arrangements to sector budget support, largely from donors who previously had contributed to the pooled funding arrangements,
>
> The detailed tables by ministry include a line item separately identifying expenditures financed by sector budget support (separately for each separate donor providing sector budget support). Thus, through the relevant classification codes, it is possible to track the use (execution) of sector budget support by economic item.
>
> In theory, sector budget support should be planned in the same way as domestic resources, with the only difference being that the relevant sector ministries are supposed to achieve particular results in accordance with the accompanying sector policy matrix. In Mali, these resources are in practice treated differently to domestic resources; in effect, they are treated as if they were project resources since they are planned separately, their use is separately identified as line-items and tracked in the budget, and in budget execution reports. Furthermore, the resources are directed towards particular purposes (e.g. training workshops), which may or may not be how these resources would have been used had they been planned together with the rest of the ministry's resources (as opposed to planned separately).

Although this approach does not conform to the generally accepted definition of budget support, it does suggest a mechanism by which project aid in Mali might be brought on budget.

Source: Aid On Budget Mali Case Study.

Good practice considerations

Priorities for PFM reform

6.19 PFM reform programmes should seek to increase the willingness of partners to bring aid on budget by increasing the budget's credibility, as well as facilitating the practical process of incorporating aid in the budget. Key (interlocking) areas for PFM strengthening to bring aid on budget thus include:

- charts of accounts and budget classifications that enable sources and uses of funds to be clearly identified in the budget and monitored during budget execution;
- measures to ensure discipline in budget management (so that there is close correspondence between budget and outturns – see Box 25 above);

- a planning and budgeting calendar that shows when donor inputs are required, complemented by clear lines of communication within government and between government and aid agencies.

Joined-up budgeting – recurrent and development budgets

6.20 Separate development budgets may make aid more visible, but often at a price in fragmenting the planning and budget system. Rwanda's reforms (Box 27) seek to integrate recurrent and development budgets in a way that still enables sources and uses of aid funds to be clearly identified.

6.21 Some other countries with dual budgets have not gone as far in integration as Rwanda plans to. However, even if development and recurrent budgets are presented separately, the links between them can be strengthened by applying a common classification system. Another important mitigation is to ensure that the same administrative unit prepares both budgets (at central and sector levels). This can reduce the problems of integrating project and programme aid into budgets.

Box 27: Integrating recurrent and development budgets – Rwanda's approach

Until the 2007 budget, all development projects were classified in the "development budget", using a specific economic classification which did not allow the separation of recurrent and capital expenditure. (75% of the development budget was externally financed.)

Major reforms in the budget presentation should start being implemented with the 2008 budget. Domestically and externally financed expenditures will be jointly presented under each ministry, instead of having a separate development budget covering donor projects. The same chart of accounts will be used to classify both domestically financed expenditures and donor projects.

The 2008 budget will start using the new chart of accounts which no longer provides for a separate 'development budget', but clearly separates recurrent and capital expenditures. As a result, project expenditures will need to be classified according to the same chart of accounts as the rest of the budget, i.e. separating recurrent and capital expenditure.

The integration of projects into the National Budget will also require training of project coordinators and line ministries to ensure that the new budget classification is applied appropriately to projects, and sub-dividing big, multi-sectoral projects into project components in order to ensure they are accounted for where they belong (sector, ministry, programme) instead of being lumped in one place.

Source: Aid On Budget Rwanda Case Study.

Showing how aid has been used

6.22 Keeping aid off budget is one strategy for an aid agency that wishes to ensure that its aid is separately identified and channelled to specific activities. However, such earmarking can be accommodated on budget if the budget codes are able to identify both the sources and the uses of funds in detail (and if the regular accounting system provides timely and credible reports in the same format).

6.23 For many donors, however, earmarking is not an end in itself. They have a broader concern that their aid should add to the total resources addressing particular objectives (e.g. to achieve the MDGs for health or education). A number of countries have adopted broader tracking mechanisms which, in the context of dialogue with aid partners, help to demonstrate the focus and the additionality of aid, without requiring programmatic aid to be strictly earmarked to particular budget items. For example:

- In Uganda a notional Poverty Action Fund has been used to channel HIPC resources and budget support to priority sectors, and to identify budget lines that are protected from within-year budget cuts.[28]
- In Ethiopia, the Protection of Basic Services (PBS) project supplements federal grants to regions and districts, enabling them to maintain and expand primary health, education and other services. Aid agencies and the federal government jointly monitor the additionality of PBS funding, the fairness of sub-national allocations, and regional/district performance, but without compromising local authorities' discretion to manage their own budgets.
- In Tanzania, the Strategic Budget Allocation System (SBAS) links budget spending not to priority sectors in the PRS, but to priority outcomes.

These mechanisms bring more aid fully on budget while allowing for risk management regarding effectiveness and fiduciary concerns.

Making budget information more accessible

6.24 Information contained in the budget is often obscured by poor presentation. Country studies found that information on aid as a source of funding was often too highly aggregated to be checked. The division of information between recurrent and development budgets may make it difficult to see an overall picture (e.g. at sector or agency level). Budget documents may present masses of line item detail without analytical summaries or narrative explanation. Poor presentation frequently undermines the translation of strategic planning for aid into annual budgeting, and impairs the quality of capture of aid on budget.

Putting aid on parliament

The relevance of putting aid on parliament

6.25 The strict interpretation of putting aid on parliament is that external financing should be included in the revenue and appropriations approved by parliament. Parliament is legally responsible for authorising expenditure by the executive branch, and inclusion of aid within the appropriated budget signifies that the government should be accountable to parliament for aid-funded expenditure.

6.26 In practice, however, aid may be brought to parliament's attention in ways that fall short of formal appropriation. The country case studies therefore reviewed the overall role of parliaments in the budget process, checking the extent to which parliaments are informed about aid, and the extent to which aid is subject to parliamentary debate and review, even if not formal appropriation. Three levels of parliamentary involvement may be considered: at the level of the strategic framework for budgets, at the level of approving annual budgets and particular aid agreements, and at the level of reviewing audit reports (see the discussion of putting aid on audit, ¶6.48ff below).

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[28] The Ghana MDBS has also been used very effectively to channel donor funds to addressing poverty reduction. See the 2007 evaluation of Ghana MDBS (Lawson et al, 2007).

Factors influencing aid on parliament

Scope of parliamentary approvals

6.27 The case study countries varied in the extent to which external finance was incorporated, and made visible, in the budgets submitted for parliamentary approval. This partly reflected differences in legal frameworks, but also different degrees of diligence in following the legal requirements. Even in countries where parliament explicitly does approve project aid (and is not simply informed about it), parliamentary discussion tends to be limited. In Rwanda's case, for example:

> Parliament approves the Budget Law as a whole, comprising budget support and the donor-financed projects presented in the Development Budget. The discussion in Parliament nevertheless focuses on recurrent budget and on internally-financed development budget. The only aid modality on which Parliament has a real say is therefore budget support. In practice, although the externally-financed part of the budget goes to Parliament, it only includes projects that have been signed already, therefore projects that Parliament cannot modify. Regarding loans, as stated in Article 54 of the Law on State Finance and Property, each of them should be approved by Parliament. Therefore, while the Minister of Finance is requested to approve all externally financed support, Parliament approves only loans.
> (Aid On Budget Rwanda Case Study.)

Quality of parliamentary review

6.28 The quality of parliamentary review was generally weak. This applies to all resources, and reflects weaknesses in the capacity and staffing of parliaments themselves, characteristically rushed timetables for review, poorly presented budget documents, and, often, a political environment in which proposals presented to parliament are not strongly contested (e.g. because of strong party cohesion across the executive and parliament[29]). The Kenya researcher noted a general finding:

> Lack of parliamentary scrutiny of proposals regarding the use of external funding has less to do with transparency on the proposed use than with weak and even inappropriate engagement of parliament in the budget process, and weak capacity.

6.29 Mozambique presents a similar scenario, where capacity constraints have limited the extent and quality of parliamentary debates on aid and the budget. The Mozambique case study argues that these problems have been heightened by the little attention that parliament has received from donor agencies in the past decade:

> ... the quality of both the approval and review of the budget and its accompanying documents is generally considered weak (see, e.g., de Renzio and Sulemane, 2006). This is partly because parliament's lack of technical, human and financial resources undermines its ability to undertaking a thorough analysis and control of budget proposals and execution, including in its external component. Whilst some donors are, directly or indirectly, supporting capacity building initiatives for the Mozambican parliament, the small size of these projects and Parliament's very weak technical and human capabilities base suggest there is significant scope to work at this level and, this way, improve parliamentary oversight of the national budget, including in its external component. (Aid On Budget Mozambique Case Study.)

6.30 Another important factor identified in the Mozambique country study is the political context in which parliamentary activities relating to the budget (budget approval, parliamentary expenditure control, etc.) take place:

> In addition to parliament's weak capacity, the 'politicization' and the underlying tensions between the (FRELIMO) government and the main opposition party, RENAMO, impede an in-depth and more objective examination by this chamber of the government's budget proposals and subsequent budgetary

[29] This is a factor in many donor country parliaments too.

performance. Ultimately, these tensions end up by affecting the quality of parliamentary budget debates. (Aid On Budget Mozambique Case Study.)

Good practice considerations

6.31 Reasons for weak parliamentary engagement in budgeting are deep-seated and not likely to be quickly transformed. Issues with whether and how aid is 'on parliament' have little to do with how aid is managed, but rather with how the budget as a whole is managed. Nevertheless there is merit in:

- Ensuring that legal requirements concerning parliament's role are observed by governments and donor partners alike.
- Ensuring that parliament is informed about aid flows even in cases where it does not formally approve them.
- Strengthening the engagement of parliaments in the budget process generally, e.g. by:
    - Engaging parliament in the discussion of medium-term strategies.
    - Improving the accessibility[30] and transparency of the budget itself and of related documents.
    - Strengthening parliamentary procedures and staffing (e.g. strengthening the staffing of specialist committees).
- Supporting civil society efforts to hold governments accountable for public expenditure. (This may include strengthening the role that political parties play in parliamentary budget processes.)
- Seeking accountability to donors in ways that complement, and do not undermine, governments' domestic accountability, including accountability to parliament.

Putting aid on treasury

The relevance of putting aid on treasury

6.32 Aid is on treasury when "external financing is disbursed into the main revenue funds of government and managed through government's systems" (definition in Chapter 2, Box 3). The rationale for putting aid on treasury is to support government's financial management systems and capacity, to facilitate efficient cash management and reinforce financial discipline, and to facilitate aid capture on other dimensions. Not all funds channelled to government bodies are on treasury (cf. the distinction between Channel 1 and Channel 2 disbursements, also explained in Chapter 2). Equally, aid may be on budget without being on treasury. However, on treasury is a pivotal dimension, both because of its direct importance and because of its influence on other dimensions: thus, when aid is disbursed through the treasury system, the treasury has to be provided with necessary information to trigger disbursements, and this supports the on-budget and on-accounting dimensions too.

[30] "Accessibility" implies user-friendliness not just availability of documents.

Factors influencing aid on treasury

Incentives and disincentives for including aid on treasury

6.33 Donors' reliance on treasury systems for disbursement of aid depends on their assessment of the financial risks involved, as well as the technical capacity of the treasury system to meet other donor requirements (which, as discussed under on budget, may include the separate identification and earmarking of a donor's funds). Thus many of the factors discussed under on budget are also relevant to the on treasury dimension. In addition, there are frequently concerns about the efficiency, not just the probity, of treasury disbursement procedures. MDAs, as well as donors, may prefer parallel disbursement systems if these are considered more likely to ensure (timely) delivery of funds to particular sectors or sub-national levels. In practice, concerns about public procurement standards act as a deterrent to putting aid on treasury, although aid can be, and frequently is, on treasury while following special donor procurement procedures.[31]

Approaches to different aid modalities

6.34 All forms of budget support are, by definition, on treasury. On the other hand, the case study countries included several where the use of treasury systems for project aid disbursements is minimal. As noted, this is treated almost as a matter of definition in Ghana, and as a corollary of the legal framework in the francophone countries. In Uganda, no system for Channel 1 disbursement by aid projects has been introduced (this is despite the fact that, since 2003, parliament has legally approved project aid as part of the budget, and seems to reflect government's preoccupation with budget support as the preferred modality for incorporating aid fully into government systems). Tanzania, in contrast, has deliberately created a channel to disburse project aid through the treasury system.

6.35 Several countries have made notable gains by bringing pooled sector funds on treasury that were formerly managed in parallel. This has been a focus of joint government–donor efforts to bring more aid on budget in Mozambique, and also in Tanzania. Pooled funds have also been moved on treasury in Burkina Faso and Mali (see Box 26 above). In Ethiopia, Channel 2 disbursements have largely given way to Channel 1 (with and without earmarking).

Good practice considerations

Priorities for PFM reform

6.36 The same features of PFM systems that are important for bringing aid on budget are also relevant to bringing aid on treasury (see ¶6.19–6.21 above). In order for donors (and beneficiaries) to have confidence in treasury disbursement, it is particularly important to address both the discipline and the efficiency of treasury disbursement. Measures that have been effective in the case study countries include the strengthening of expenditure processing linked to reformed budget classifications, and capacity building. In some cases (e.g. the SISTAFE system in Mozambique) the introduction of IFMIS modules has contributed to the strengthening of treasury systems.[32]

[31] South Africa's RDP fund provides a special case: funds disbursed through the RDP fund are thereby on treasury, but since they are not being disbursed through the central revenue fund, their procurement procedures can be specified in the aid agreement. More generally, earmarked aid that is on treasury may have special procurement stipulations attached.

[32] However, introduction of an IFMIS is not a panacea. Research reported in 2003 (Dorotinsky, 2003, cited in Parry, 2004) showed that for 34 IFMIS projects in 27 countries funded by the World Bank (at an average of USD12.3m per country): only 21% were successful; only 6% were regarded as likely to be sustainable; and, they took an average of 7 years to complete.

6.37 Across a range of countries, the introduction of Single Treasury Accounts (STAs) and related efforts to strengthen bank account management have had a strong effect. The Mozambique country report provides an example – see Box 28. Ghana and Rwanda are among other countries pursuing similar reforms. In Uganda, as a separate measure, the government has required bank accounts for project aid to be held at the central bank, rather than commercial banks; this has improved information and supervision by the accountant general.

Box 28: Bringing aid on treasury through the Single Treasury Account in Mozambique

The Mozambique government, together with its aid partners, has been working to merge all financial accounts into one single treasury account – *Conta Única do Tesouro*, CUT – and to bring all available sources of funding, both internal and external, under the umbrella of the Mozambican integrated budget and PFM system. Donor agencies who belong to the Programme Aid Partners group have agreed to disburse at least 60% of its development assistance to the government through the single treasury account system by 2009.

Since 2007 some of the larger sectoral common funds are now being managed through the CUT and are, therefore, on treasury. These include common funds in agriculture, health and education (as well as a fund that supports PFM reform!).

The establishment of the single treasury account has been instrumental in the process of putting aid on budget in Mozambique and bringing its associated PFM benefits. Its creation directly addresses one of the main causes behind the phenomenon of off budgets: the lack of transparency within the treasury system, which deters donors from using local public financial management systems. At the same time it is perhaps one of the most visible manifestations of the PFM benefits brought by aid capture on treasury, given the immediate benefits the government/treasury draws from having the number of accounts it uses for its treasury operations reduced to one.

Source: Aid On Budget Mozambique Case Study.

Donor practices

6.38 Donors can contribute to more effective aid capture on treasury in a variety of ways:

- by giving early attention to the design of disbursement procedures when preparing aid interventions, and taking account of the nuts and bolts of the partner country's PFM system when doing so;
- by bringing existing pooled funds on treasury, and designing new pooled funds to be on treasury from the outset;
- by improving the predictability and front-loading of budget support disbursements (so as to assist government's liquidity and cash-flow management).

Putting aid on accounting

The relevance of putting aid on accounting

6.39 Aid is on accounting when "external financing is recorded and accounted for in government's accounting system, in line with government's classification system" (definition in Chapter 2, Box 3). Aid is not fully on accounting if special additional financial reports are stipulated (see discussion of on report, ¶6.56ff below). The rationale for using the government accounting system as much as possible is to strengthen government financial systems, to minimise transaction costs and demands on government capacity, and to ensure that government accounts provide a comprehensive view of the government's finances.

6.40 Aid may simultaneously be on accounting and not on some other dimensions. For example, there are ways in which aid that is not on treasury, or not appropriated through the budget, may still be recorded in government accounts. However, there is valuable synergy if aid is on treasury as well as on accounting, since the need to justify treasury disbursements provides a strong incentive to keep government accounting records up to date. Credible and timely accounting for disbursements may be a crucial factor in aid agency willingness to use Channel 1.

Factors influencing aid on accounting

Incentives and disincentives for including aid on accounting

6.41 Whether aid is brought on accounting is largely a corollary of the incentives for being on treasury, but the incentive works in both directions, since reliable accounting is a prime concern in either case. Donor preferences are strongly influenced by the issues in budget classification and charts of accounts that have already been discussed, but a crucial factor is the ability of the government accounting system to deliver reliable and timely expenditure reports. In several of the case study countries, long backlogs in closing government accounts, as well as delays in reporting, have been a major problem, but there have been impressive strides in reducing backlogs and strengthening accounting systems as part of PFM reforms and capacity development.

Approaches to different aid modalities

6.42 Budget support is inherently on accounting, and its use gives donors an enhanced interest in the quality of government accounting as a whole. PFM reform programmes and conditions linked to HIPC and budget support have been instrumental in strengthening government accounting systems.

6.43 Government approaches to putting project aid on accounting are influenced by different legal traditions. Mali illustrates a francophone approach, where the responsibility of the financial controller is expressly limited to the accounting of funds that are on treasury; apart from budget support, aid funds are disbursed by project implementation units and accounted for separately, while producing consolidated accounts seems not to be a priority for government or donors. Tanzania has, more recently, made strenuous efforts to bring all modalities on accounting. It has arrangements whereby funds not on treasury are on account (because of pooled funds with parallel disbursement systems, but government accounting); the same mechanism can incorporate aid-in-kind into the accounts (see Box 29).

Good practice considerations

6.44 Since disbursement through treasury is not practical for all donors (or appropriate for all types of aid), mechanisms to record aid-in-kind in government accounts are a good practice (see Box 29; Kenya also tries to capture aid-in-kind, in line with its financial legislation). More fundamentally, there has been a major contribution from the accounting reforms which have raised the speed and quality of government accounting in many countries.

Box 29: Tanzania – aid-in-kind and dummy entries

The following extracts from Tanzania guidelines illustrate an approach to recording aid-in-kind in the mainstream government accounting system.

Direct Disbursements to the Project and 'In Kind' Assistance

There are instances where donors disburse directly to the project or provide in-kind assistance (donor procurement, recruitment of consultants, project staff engaged at the donor office). […] The Government is encouraging all donors to route their resources through the Exchequer. However, where direct disbursements occur, the procedure used to account for such transactions is as follows:

(i) The donor disburses funds or provides goods or services directly to the project.

(ii) The project then reports on the amounts, goods, services or equipment value received to the relevant MDA with relevant supporting evidence of the disbursements and purchases.

(iii) The MDA raises a TFN 358 application form in the normal manner. However, since expenditure has in this case been already made, copies of payment vouchers and other supporting documents will be attached to the TFN 358 (…).

(iv) The Budget Division, upon satisfying itself, will grant a release warrant to the Accountant General.

(v) The Accountant General will now issue a Dummy Exchequer Issue Notification (for record purposes only since there is no actual cash outflow) and such issuance will be recorded in the Integrated Financial Management System. At this stage, the expenditure will now have been incorporated in the Government Accounts.

Source: Government of Tanzania, 2005.

6.45 For donors who are not disbursing through Channel 1, good practice requires the timely provision of expenditure information in formats that match the government's accounting classifications.

6.46 The key good practices for governments seeking to bring external funds on accounting are:

- to ensure that the accounting system provides a proper framework for reporting transactions, including those involving external funds;
- capacity development to ensure the quality and timeliness of government accounts at all levels.

6.47 There are now internationally recognised accounting standards for aid which provide attainable standards for countries using cash-based accounting systems – see Box 30.

Box 30: Good practice: follow international accounting standards for aid (IPSAS)

In 2003 the internationally recognised accounting standard, IPSAS (International Public Sector Accounting Standard) for cash-based financial reporting was issued by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants. This is relevant to developing countries as the vast majority of their governments do not have accrual-based systems.

When this was adopted there were calls for an internationally accepted accounting standard for reporting external assistance. Since 2005 IPSASB has undertaken a consultation process on exposure drafts to amend the Cash Basis IPSAS to include additional required and encouraged disclosures for recipients of external assistance, issuing Exposure Draft (ED) 24 in 2005 and ED 32 in 2006. ED 32 proposes a split into mandatory and recommended disclosures under the cash basis of accounting.

The mandatory requirements include "*show separately total external assistance received in cash, show [aid in kind] i.e. payments made on government's behalf by a third party, break down by different providers, show grants and loans separately*" and others.

Following field tests in 2007, the IPSASB approved IPSAS, *Financial Reporting Under the Cash Basis of Accounting – Disclosure Requirements for Recipients of External Assistance*. The IPSAS (to be housed within the cash-basis IPSAS), is planned to be issued early in 2008. Full details are available from the IPSASB website:
http://www.ifac.org/PublicSector/ProjectHistory.php?ProjID=0067

Putting aid on audit

The relevance of putting aid on audit

6.48 Aid is on audit when "external financing is audited by government's auditing system" (definition in Chapter 2, Box 3). As with other dimensions, the country case studies looked beyond the formal question whether aid is included within the scope of government audits and considered also the quality of auditing that takes place. Of course donors (and especially budget support donors) have an interest in the auditing of domestically-financed expenditures as well. The rationale for using national audit systems is to conform to national lines of accountability and to support the strengthening of national systems.

Factors influencing aid on audit

6.49 Whether aid falls within the scope of the national audit process depends on the national legal framework, on the availability, in practice, of the records on which audits focus, and on the capacity of the audit bodies and the auditing process.

6.50 The national legal requirements for the audit of externally financed expenditures often exceed what actually occurs. For example, public finance legislation in Tanzania explicitly requires that all aid, whether paid in cash or in the form of goods and services, should be subject to audit by the Controller and Auditor General. Kenyan legislation similarly requires that all donor-funded expenditure should be audited by the Auditor General. In practice the scope of government audit is commonly limited to funds that are on budget and on accounting, so may implicitly exclude most aid (though budget support is inherently covered). In a number of cases Auditors themselves have highlighted this as an anomaly. Thus:

- The Burkina Faso study noted that non-GBS ODA expenditures are not included in government accounts, and are therefore not regularly checked by the Court of Auditors. The Court is aware of this. Recommendations made whilst checking the application of the financial management law of 2003 and repeated since are that "external funding processed by [the directorate for cooperation] should be sent to the Treasury for accounting". This is scheduled for 2008.
- In Uganda, in the 2004/05 report the Auditor General states:

  > *"A scrutiny of the approved budget revealed that various projects received funding from un-appropriated sources/donors. From a sample tested $23,972,298.87 … was disbursed to projects outside the approved budget. It appears therefore that information provided to parliament for approval is inadequate with regard to donor funded projects."*

6.51 Even where national audit offices do work of high standard, they tend to be thinly resourced and limited in the volume of work they can manage; hence the proportion of funds/agencies subject to audit in a given year may be worryingly low. Auditors are further constrained by delays in the submission of accounts. As a consequence, their reports may be submitted late, and this contributes to a generally poor record of parliamentary follow-up of audit findings. (See also the earlier discussion of parliamentary capacity, ¶6.26ff.)

6.52 Against this background, audit arrangements are often the subject of special conditions attached to specific aid instruments. These may require an external audit, or an undertaking by the Auditor General to conduct (or to commission) a special audit.

Good practice considerations

Support to audit capacity

6.53 Support to the capacity of audit bodies is likely to be a long term requirement, and could complement long-term action to strengthen parliamentary Public Accounts Committees, as well as civil society demand for accountability. Direct support can be complemented by efforts to strengthen the demand for audit services. For example the Uganda case study notes that, in the context of the move towards budget support, the Auditor General has benefited from significant institutional support in recent years, and also the timely preparation of audits has been a key focus of conditionality. This has helped underpin improvements in quality and timeliness of audit reports. Similar developments are taking place in Mozambique where, with the growth of budget support to the government, several donors have started supporting the Administrative Tribunal (the body responsible for external auditing) with various capacity building initiatives which have improved the scope and quality of its audit exercises on the budget, including its externally funded components.

6.54 Where special audits are to be commissioned, donors can avoid sidelining national audit authorities by involving them in the commissioning of audits. (In several countries, such involvement is required by law.) There is also scope for harmonisation of donor audit requirements (as happens through various forms of pooled funding).

Complementary approaches to fiduciary and other assurances sought by donors

6.55 Formal ex post audit is only one element of fiduciary assurance. Donors often seek much more immediate comfort about the use of their funds, and are concerned with wider questions about how well resources are used. Relevant complements include internal audit as an aspect of the control environment when funds are put on treasury, ongoing financial reports and reviews to verify the application (and in some cases the additionality) of aid funds, and diagnostic studies such as public expenditure reviews and public expenditure tracking surveys. There is thus a need to think broadly about the range of "audit" that may be required both for accountability and for monitoring and improving aid effectiveness, and to implement in ways that engage governments and harmonise donor efforts.

Putting aid on report

Relevance of putting aid on report

6.56 Under "on report" this study considered whether external financing is included in ex post reports by government (definition in Chapter 2, Box 3). This dimension acknowledges that the monitoring of public expenditures involves a much wider range of (financial and other) reports than those provided by the formal accounting system. It is possible that aid which is not incorporated in the formal public accounts may nevertheless appear in such reports.

6.57 The definition of relevant reports is rather open-ended, but the study focused on reports which are owned by governments, and which are consolidated. In addition to the formal accounting records that are produced, there is potential for other reports (e.g. budget execution reports, consolidated sector reports) to provide valuable management information and to integrate externally funded activities in the process. For example, such reports may provide additional detail on funds that, in budgeting terms are disbursed as block grants to agencies or tiers of government.

Factors influencing aid on report

6.58 A general lack of strong government monitoring and evaluation systems means that monitoring and evaluation of aid is also incomplete. In-year reporting is often of poor quality, and, in some cases, government reluctance to share information limits its wider value. There are systematic efforts, in some cases (e.g. Rwanda, Kenya) to produce systematic reports on aid at national level or by ministry, but problems in government capacity to obtain, assemble and use such information are shown by persistent discrepancies between information assembled from different sources (e.g. country-assembled data vs. aid flows reported to the OECD DAC). At the same time, the DAC harmonisation agenda has stimulated more efforts to supply and use relevant information on aid. Sector approaches and sector working groups have stimulated the preparation of sector-specific and general reports.

6.59 The most ambitious efforts are so-called Aid Information Management Systems (AIMS), (see discussion in the Literature Review: ¶41–¶43), of which the most conspicuous in the study's sample countries were the Aid Management Platform (AMP) in Ethiopia, and the ODAMOZ database in Mozambique. The latter is functioning as a useful adjunct to efforts to bring aid directly on budget (see Box 31), but the AMP in Ethiopia, though more ambitious, is not yet operating as an effective shared resource between government and donors. In many cases (of which Rwanda and Tanzania were conspicuous examples) a multiplicity of expenditure, accounting and reporting databases have accumulated. However, weak linkages between these databases detract from the comprehensiveness and quality of reporting. This makes it difficult to link financial reports, to non-financial (activity, outputs, outcomes and impacts) reporting. Often the multiplicity of reports and databases reflects a fragmentation of responsibilities within government, and there is a need for rationalisation and streamlining of such reporting. There is a risk that reports, when available, do not reach domestic stakeholders, but are oriented primarily to the demands of external aid agencies.

Box 31: The ODAMOZ database in Mozambique

International development agencies have made efforts in Mozambique to systematically compile, report and publish information on the ODA projects they operate or support. This is now being reported on a regular basis in the ODAMOZ web-based database (see www.odamoz.org.mz), which includes detailed information for all projects funded by agents participating in this aid dissemination project and is an important source of ODA information for the government. Since 2006 this database is being managed by the Ministry of Planning and Development, whilst efforts are being made to encourage its use by both donors and government agencies (GOM/PAP, 2007c: Annex 4:14).

(¶4.5). Whilst ODAMOZ has been an important step in improving information flows between donors and the government, worthy of being emulated by other countries, efforts to put *aid on budget* should not be seen as limited only to a process of greater information generation and sharing.

Source: Aid On Budget Mozambique Case Study.

Good practice considerations

6.60 Reporting has costs, and the quality of reports depends on reporters have a continuing incentive to provide timely and accurate information. Consolidated reports can add value by capturing more aid than is directly reflected in the government's financial management systems, especially if financial data can be linked to information on activities, outputs and outcomes. Incompatibility of reporting categories, timetables and formats is a continuing challenge. Donors need to adapt to government, classifications, currency, time periods and reporting timetable in order to increase the value of such reports. At the same time, demands for reporting should take account of capacity, and be linked to efforts to strengthen analytical capacity in particular.

Decentralisation

6.61 The case study countries show a variety of approaches to decentralisation. Ethiopia has a fully-fledged federal system, with lower tiers mainly funded by unearmarked transfers from the federal government. Uganda also has a highly developed intergovernmental transfer system, but based on much more tightly controlled specific–purpose grants. Several other countries (e.g. Rwanda, Mozambique) have decentralisation reforms under way which aim to increase responsibilities and public expenditures at local levels, and are simultaneously urging aid agencies to channel local-level financial support through the government financial system.

6.62 In all cases, decentralisation poses a special challenge to bringing aid on budget. On the one hand, aid that its channelled to decentralised bodies or focused on specific geographical areas is often hard to capture for planning and budgeting purposes. On the other, one of the deterrents to bringing aid on budget is a fear that disbursement via central government (Channel 1) will not reach local levels fairly or efficiently. Mozambique is a prime example of this dilemma. Government and aid partners have worked to bring more aid on budget, through pooled sector funds; these efforts have been linked to the strengthening of financial management subsystems and the introduction of a computerised financial management system. There has been substantial progress, but the delivery of resources to local level through the government system is still problematic.

6.63 The Uganda case study included a special review of decentralisation in the context of putting aid on budget. Its conclusions are summarised in Box 32. Both the Ethiopian[33] and Ugandan experiences show that, instead of creating parallel mechanisms through projects and basket funds, sector budget support can be channelled though a government's intergovernmental transfer system in support of local service delivery. This helps build local government budgetary and service delivery systems, and donor fiduciary concerns can be addressed through tracking resources via the transfer system, and building local systems. However, both cases benefited from a strong political support for decentralisation, and a capable central finance ministry able to ensure the efficient disbursement of grants to sub-national levels.

Box 32: Decentralised services on budget in Uganda

The Uganda case demonstrates firstly that capacity can effectively be built whilst using the inter-governmental transfer system and local government systems, even from a very weak starting point. It also demonstrates that strong government initiative has helped bring aid on both budget and on financial management systems in local governments – this has meant that off-budget pooled funds became far less prevalent in Uganda than other similarly aid dependent countries (e.g. Tanzania, Mozambique).

The following lessons can be drawn:

- Firstly is the importance of the government developing a clear and transparent fiscal transfer system, where grants to local governments are clearly identifiable in the budget.
- Secondly is the need to address donor fiduciary concerns directly by developing initiatives which ensure transfers are protected and can be tracked, whilst strengthening local government budgeting, accounting and reporting systems.
- Thirdly demanding capacity from local governments helps build capacity, and this can be done by enforcing existing systems, and providing explicit incentives through initiatives such as the Local Government Development Programme (LGDP) assessment.

Yet it also shows that a fragmented government system can have a detrimental effect just like fragmented projects, and increase transaction costs. These costs need to be weighed up against the benefits of using earmarked sectoral transfers as a means of tracking resources to basic services.

Source: Aid On Budget Uganda Case Study.

[33] See detail in ¶6.23 on the Protection of Basic Services (PBS) project in Ethiopia.

7. CONCLUSIONS AND RECOMMENDATIONS

This chapter provides recommendations (for individual governments and donors, and for joint action). The recommendations focus on practical ways of strengthening aid effectiveness by bringing aid on budget.

Introduction

7.1 Overall this study has found undoubted progress, achieved and under way, in bringing aid on budget, but there is still a lot of scope to improve the alignment and integration of external and domestic resources. This requires attention to the quality of capture on all dimensions as well as the volume of aid that is recorded in budget documents. Chapter 6 has identified many good practices (and some bad ones), related to each of the "on budget" dimensions considered by this study. This final chapter draws on them to present a coherent set of recommendations for governments and for donors, and for governments and donors acting jointly. It first considers the overall approach, and the scope for progress with different aid modalities.

Overall approach to improving aid capture

Drivers of progress in putting aid on budget

7.2 The country studies have highlighted the ways in which government and donors working together (especially if led by government) can make progress in strengthening effectiveness, including putting aid on budget. Often the dialogue around budget support and SWAps is a valuable focus. (Hence, as noted, the most striking gains in bringing aid on budget have been through the use of budget support and by bringing pooled funds on budget.)

7.3 Improvements in PFM are a fundamental factor in bringing aid on budget. At a general level they can increase donor confidence in government systems, and support a virtuous circle in which the integration of aid in country systems strengthens those systems and encourages the further integration of aid. At a specific level, the nuts and bolts for integrating aid are the nuts and bolts of the PFM system.

7.4 There has been growing consensus on the characteristics of effective PFM (supported by many good practice guidelines and encapsulated in the PEFA criteria). And – as all the country studies observe – the DAC harmonisation and alignment agenda, now embodied in the Paris Declaration, has had a galvanising effect on the efforts of donors and partner governments at country level.

7.5 At the same time, factors other than the quality of PFM are also important –as implied by the rather weak correlation between overall measures of PFM quality and the use of country budget systems – cf. ¶4.17–4.18 and Box 15 above). A recent study of donors' approaches to risk in the use of country systems explores both the financial and non-financial factors involved, and is also highly relevant to the issues discussed in this report. (Mokoro Ltd and CIPFA, 2008.)

Where are the potential gains?

7.6 Budget support is automatically on budget in most if not all dimensions. For this and for other reasons it makes sense for partner countries to create favourable conditions for (general and sector) budget support, and to encourage donors to provide more of their aid in that form. There are risks attached to budget support, for recipients as well as donors, and it is in both sides' interest to design forms of budget support that mitigate these risks.

7.7 However, budget support has limits, and project aid has been growing. The problems associated with poorly integrated project aid still loom large. The bigger challenge, therefore, is to bring project aid on budget (see Box 14, Chapter 4). The Rwanda study noted the challenges as follows:

> The shift to budget support clearly is and remains the most efficient and comprehensive way of 'putting aid on budget'. Nevertheless, a lot can be done to improve the way projects are integrated into the national planning, budgeting, accountability, accounting and auditing processes. Somehow the international pressure that has led some donors to shift to budget support has so far led to less concrete results in terms of shifting projects on-budget. This may be partly linked to the complexity of the issue. In that respect, making sure aid is reflected on the budget is only a first step in the process. It is an essential step, since transparency will allow better planning, allocation, and accountability.
> Nevertheless it is essential for local donors and Government to push the reflection further than mere data collection, in particular towards how to ensure project planning and pipeline is aligned to government priorities, how projects can be integrated into the single treasury account, and how project execution can pass through SMARTGOV [the financial management system] and abide by the Law on State Finance and Property. (Aid On Budget Rwanda Case Study.)

7.8 Several countries have paid special attention to designing procedures for managing externally financed projects within government systems. (Tanzania is one example; Mali's so-called sector budget support – described in Chapter 6, Box 26 – could be considered another.) In other cases, the integration of projects has been surprisingly neglected. The Uganda study notes:

> As well as appearing on the revenue budget, project aid may use government procurement systems, but no projects use the government's accounting systems. However, to date a mechanism has not been developed through which project expenditures funded by donor aid can use either the automated accounting systems at central government, or a manual one.
>
> A key problem has been the fact that project-based budgetary systems have not changed over time to evolve with the MTEF and sectoral processes. This is largely because it was widely perceived that budget support would become the dominant modality, but project aid has remained and is now growing again. Another implication of this is the lack of thinking that has gone on with respect to how projects can use domestic budget execution systems. (Aid On Budget Uganda Case Study.)

Priorities and sequencing

7.9 Different countries have different institutional settings, their governments have different preferences in how they relate to donors, and their PFM systems are at different stages of development and reform. Strategies for bringing aid on budget need to be tailored to these different circumstances. Relevant considerations include:

- Aid on budget issues are generally more important in more aid-dependent countries.[34]
- Sectors where substantial aid flows support public services merit more attention.
- Capacity everywhere (including aid agency capacity) is limited, and in any case technical solutions will not work unless incentives are right.

[34] On the on the hand, less aid-dependent countries, such as South Africa, tend to have stronger PFM systems. Therefore, whilst putting aid on budget in these countries may be less critical, it should also be easier, and donors should take advantage of this.

- Bringing aid on budget needs to be considered as part of an overall strategy for PFM, which will have a strong influence on the sequence of reforms.

7.10 The analytical framework of this study, with its distinction between different dimensions of the budget system, may be a useful template in considering the choice and design of aid instruments. Chapter 6 has commented on which modalities are more/less likely to be captured on different dimensions. Often, the good practices it identifies have implications for the design of specific aid instruments as well as the broad choice of modalities. It is worth considering which dimensions are more important in a particular case, and whether disadvantages of non-capture in some dimensions can be mitigated on other ones. (For example, if it is not practical to put aid on budget or on treasury in a particular case, is it at least on plan and on report? Or, as in the Tanzania case, bringing aid on account may mitigate failure to capture it on treasury.) Also, given that different donors have different preferences and constraints concerning modality and instrument design, can they focus on sectors and interventions that play to their strengths?

7.11 The Mozambique report exemplifies this way of thinking:

> It is necessary to reflect on the urgency and necessity of bringing all donor funds *on budget at all levels*, especially given the recentness of some of the key reforms undertaken in Mozambique in the sphere of public financial management, and the ongoing challenges that still need to be addressed. In some instances – for example in the case of large infrastructure projects with a high development impact, such as the construction of roads, bridges or large water and energy infrastructures – the benefits of maintaining ODA off-treasury (although not necessarily off plan or off budget) may outweigh the potential costs of processing these projects' funds through national PFM systems. This may be the case, for instance, if existing PFM systems are weak and unreliable and, thus, incapable of managing the funding and accounting requirements associated with this type of projects with the reliability and quality necessary to ensure their timely undertaking. (Aid On Budget Mozambique Case Study.)

Recommendations for governments

The PFM agenda

7.12 Bringing aid on budget should be seen as part of the overall PFM reform agenda. It should be addressed within the comprehensive, country-led programmes of PFM reform that are envisaged in the PEFA "Strengthened Approach" (Public Expenditure Working Group, 2005). It is important for governments to publicise their systems, highlight improvements, and make their procedural requirements known to donors.

7.13 The following PFM priorities are especially relevant to the integration of aid within country systems:

- Strengthen transparent medium-term expenditure planning (to bring aid “on plan”).
- Clear planning and budgeting calendar to integrate aid management with the planning and budgeting process.
- Better budget classification and presentation. (The newly approved IPSAS standards – see Box 30 above – are relevant here.) Especially relevant improvements include:
    - accurate identification of recurrent and capital expenditures (but moving away from separate “recurrent” and “development” budgets);
    - “source” codes to allow tracking of donor funds if required.
- Discipline in budget execution (which can be reinforced by many of the points which follow).

- Single Treasury Accounts (and strict control of government bank accounts).
- More timely reports and accounts.
- Transparent and efficient mechanisms for funding sub-national governments.
- More transparent budget documents:
  - to highlight plan/budget strategic links;
  - to show aid sources of budget finance, and aggregate uses of aid;
  - to facilitate more meaningful parliamentary review.

Strategies for aid management

7.14 Few countries have well-articulated strategies for the management of aid (as opposed to its mobilisation). Often the responsibilities for aid management within government are poorly defined, and the lines of communication with donors are confused. Preferences for budget support may be stated, but there is little guidance on how donors should deliver other forms of aid in ways that use country systems. The interconnections between aid and PFM are not always recognised. Some countries have recognised the need for more explicit strategies: e.g. Rwanda is in the process of developing an aid management manual to augment its 2006 Aid Policy; South Africa has such a manual; Ghana is preparing an aid strategy – see Box 33, and so is Mozambique.

7.15 Explicit aid effectiveness strategies should:

(a) Link aid management strategy to strengthened public finance management reform (effectiveness of all resources). The link begins with the making of policy through the budget process, and continues through all the phases of the budget cycle.

(b) As part of this: address unclear and overlapping responsibilities for the coordination of planning and budgeting (see the earlier comments on the integration of recurrent and development budgets and of the responsibilities for their preparation, and the need to avoid disconnecting aid management and budgeting responsibilities).

(c) Use donor information as an input into scenario planning for the PRSPs/medium-term expenditure plans, and use scenario planning as a basis for seeking longer-term aid commitment.

(d) Go beyond indication of preference for budget support modality, to specify good donor practices and standard government procedures for other modalities.

(e) Allow for dialogue about the use and the additionality of aid funds so as to reduce donor demand for earmarking and micro-management of donor funds. (See the discussion on Ethiopia's Poverty of Basic Services project and the Uganda Poverty Action Fund in Chapter 6, ¶6.23, and also the discussion of wider "on audit" approaches ¶6.55.)

Box 33: Ghana – preparing a comprehensive aid strategy

The Ghana government is in the process of developing a comprehensive aid policy, known as the External Resources Mobilisation and Management Policy**.** It is currently at the Concept Note stage.

The strategy is in response to Government and donor concerns expressed following the results of the 2006 Paris Declaration survey. This revealed:

- a lack of shared understanding between the Government and Development Partners on the definitions and concepts related to aid effectiveness;
- inconsistencies in reporting on activities financed by donor grants and loans, leading to substantial differences in the data available to the Government and the development partners;
- fragmentation of donor efforts (both loans and grants) due to the lack of the relevant policy provisions guiding allocation of foreign aid;
- the lack of comprehensiveness of aid included in the budget;
- uncoordinated provision of technical assistance.

There is also the recognition of a need for stronger Government leadership and guidance for improving aid effectiveness.

In response to these needs, the objectives of the aid policy are two-fold: (a) to increase the effectiveness of external resources to Ghana; and (b) to provide a basis on which the additional aid required by Ghana to meet its short- to mid-term investment needs can be mobilised.

The aid policy will include criteria, guidelines, and procedures for: the mobilisation of aid resources, procedures for handling different types of aid, aid reporting, and guidelines for improving sector policy frameworks. It will also specify the roles and responsibilities for aid management at all levels of government.

Recommendations for donors

7.16 The Paris Declaration commitment to increase the use of Programme Based Approaches should provide continued impetus for the greater integration of aid with government systems. Aid agencies should review their aid instruments designs, centrally and at country level, from the perspective of aligning and integrating with country systems along each of the dimensions reviewed in this study.

7.17 Agencies should in particular review the extent to which they use ***regular*** government systems. This requires investing in understanding the systems and procedures of specific recipients, and training aid agency staff accordingly. It is important to make the use of government systems a design consideration in the early stages of designing any intervention, not an afterthought.

7.18 Agencies should improve the medium-term predictability of their aid (an area in which there has been relatively little progress) and provide aid flow information that is linked to the government fiscal year, the government planning and budget calendar, and government budget classifications.

Recommendations for joint action

7.19 Working together, governments and their aid partners should:

- Recognise the continuing importance of joint government–donor action (at general and sector level) to address the greater use of government systems.
- Incorporate "aid on budget" objectives within country-led public finance management strategies.
- Strengthen monitoring of the Paris Declaration commitments:
    - set standardised and less flexible definitions at international level;
    - monitor the proportion of project aid that is on budget;
    - continue the country-level focus on use of government systems, and set country-level targets for progress.
- Rationalise aid-related databases and collaborate in sharing information on all types of aid.

7.20 Jointly setting and monitoring standards and targets for the use of country budget systems is especially important, because there are few effective sanctions on donor performance, apart from donor peer pressure and the voluntary obligations of mutual accountability between donors and partner governments.

Next steps

7.21 Many steps can be taken in the short term, but a long-term perspective is required. As the Mozambique country study noted:

> Given its structural and overarching nature, the process of putting *aid on budget* is likely to require time and a long-term perspective from all parties involved, and a gradualist approach that takes into account the many interdependencies that exist between the various policy spheres if these objectives of bringing aid on budget at all levels of the budget cycle are to be achieved. (Aid On Budget Mozambique Case Study.)

7.22 Many of the "good aid on budget practices" identified in this report are general good practices. We have emphasised that putting aid on budget is a subset of a wider agenda for aid and public finance management. Pursuing aid on budget should not become a separate, fragmented chore; it should be incorporated in wider programmes for PFM strengthening, and included among the tasks of existing general and sector forums.

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- Inception Report
- Literature Review
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