

ECONOMIC DEVELOPMENT AND NORTHERN GHANA

**CAN THE MULTI-DONOR BUDGETARY
SUPPORT (MDBS) SYSTEM IMPROVE
AID EFFECTIVENESS IN GHANA?**

By

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OUTLINE

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1. Introduction

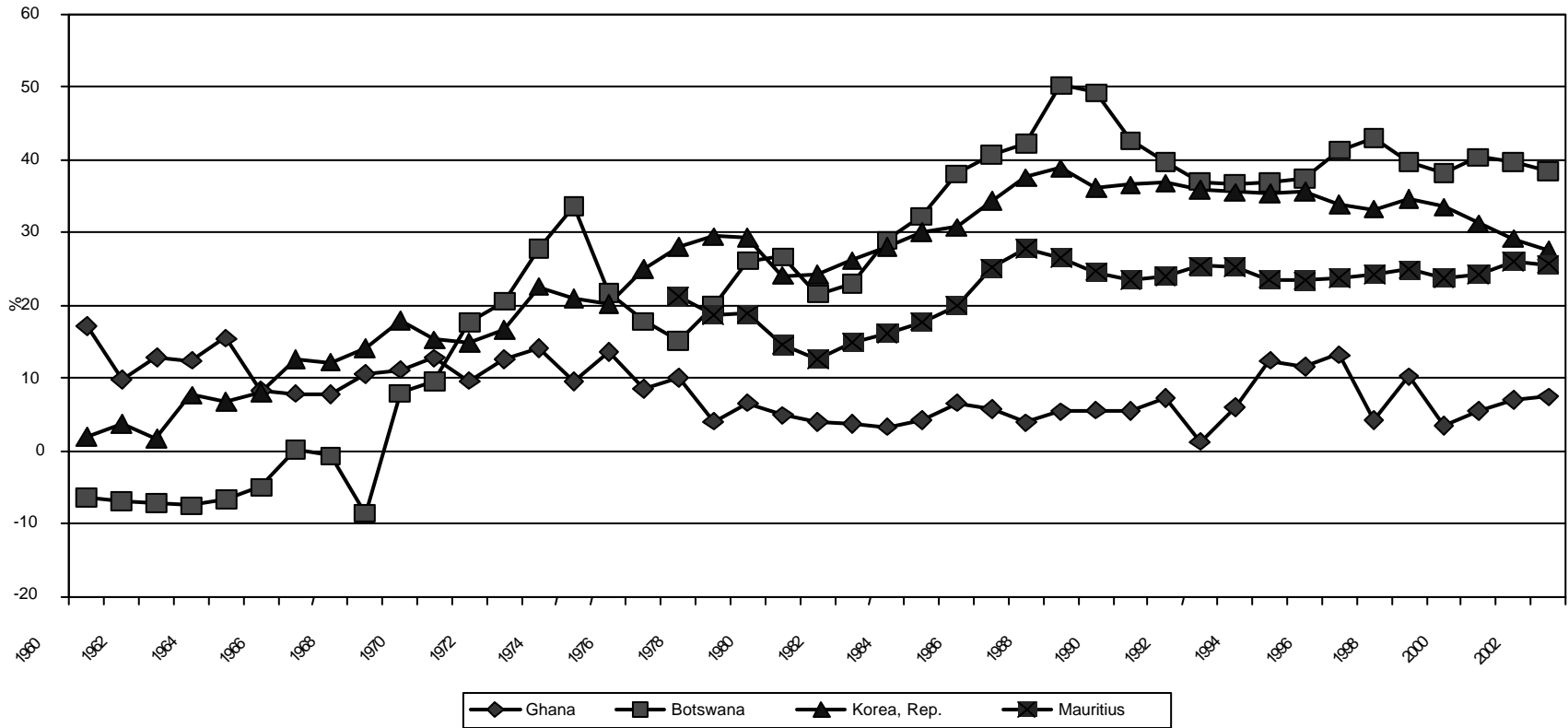
- Developing countries, including Ghana, have been burdened with severe resource problems.
- Their fiscal and current account deficits are unsustainable in the face of severe debt problems

1. Introduction

- The resource problems has been exacerbated by the low domestic savings in Ghana.
- Savings as a percentage of GDP in Ghana has been low compared to many African countries; between 1980 and 2001, it averaged 6.4% in Ghana, 37.4% in Botswana, 21.4% in Cameroon, 21.6% in Nigeria, 13.9% in Kenya and 7.3% in Malawi (WDI, 2005)

1. Introduction

Figure:1 Domestic Savings



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1. Introduction

- Ghana's inability to raise enough resources domestically to finance investment has led to its over-dependence on aid (Table below)
- Although the inflow of foreign resources into Ghana particularly after the economic reforms has yielded some positive gains, it is believed that aid has not been as effective as one would have expected.
- Aid Effectiveness is defined in terms of Aid's contribution to poverty alleviation or sustained poverty reduction

1. Introduction

| Years | % of Govt Central Govt Expenditure | % of GNI | % Gross Capital Formation | % of Imports | Aid Per Capita (US\$) | ODA & OA (Current US\$ Mil) |
|-------|------------------------------------|----------|---------------------------|--------------|-----------------------|-----------------------------|
| 1982 | 11.3 | 3.5 | 103.3 | 15.6 | 12.4 | 140.8 |
| 1983 | 5.2 | 2.7 | 71.9 | 15.1 | 9.3 | 109.4 |
| 1985 | 23.2 | 4.4 | 45.4 | 20.5 | 15.5 | 195.5 |
| 1987 | 62.1 | 8.4 | 77.9 | 31.1 | 30.4 | 412.6 |
| 1989 | 98.6 | 13.9 | 103.4 | 50.9 | 49.1 | 717.2 |
| 1991 | 95.3 | 13.6 | 84.1 | 49.5 | 56.4 | 881.5 |
| 1993 | 49.8 | 10.7 | 47.1 | 27.2 | 37.7 | 623.9 |
| 1995 | Na | 10.3 | 50.3 | 28.8 | 37.6 | 650.8 |
| 1997 | Na | 7.3 | 28.9 | 17.7 | 27.4 | 494.0 |
| 1999 | Na | 8.1 | 37.6 | 14.9 | 31.6 | 609.5 |
| 2000 | Na | 12.4 | 50.3 | 17.3 | 30.6 | 600.4 |
| 2001 | Na | 12.4 | 45.7 | 17.4 | 32.3 | 643.6 |
| 2002 | Na | 10.8 | 53.5 | 18.5 | 32.0 | 649.8 |
| 2003 | Na | 12.2 | 51.3 | 20.8 | 43.9 | 906.7 |

1. Introduction

| DONOR | YEARS | | | | | |
|----------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | 1998 (%) | 1999 (%) | 2000 (%) | 2001 (%) | 2002 (%) | 2003 (%) |
| Denmark | 5.5 | 7.0 | 6.7 | 7.1 | 9.2 | 7.4 |
| France | 0.7 | 0.7 | 0.6 | 0.8 | 1.8 | 2.4 |
| Germany | 5.0 | 6.9 | 5.7 | 4.3 | 6.1 | 6.1 |
| Netherlands | 3.4 | 2.2 | 4.9 | 20.5 | 10.6 | 8.6 |
| Norway | 0.2 | 0.1 | 0.6 | 0.1 | 0.1 | 0.1 |
| Sweden | 0.1 | 0.1 | 1.1 | 0.4 | 0.2 | 0.1 |
| Switzerland | 0.1 | 0.1 | 0.1 | 0.1 | 1.3 | 1.0 |
| United Kingdom | 10.2 | 16.9 | 14.3 | 17.6 | 22.1 | 17.1 |
| United States | 5.4 | 7.5 | 11.4 | 9.6 | 12.3 | 10.9 |
| Japan | 23.4 | 18.7 | 18.4 | 6.2 | 4.2 | 3.9 |
| UNDP | 0.9 | 0.9 | 0.6 | 0.6 | - | - |
| IFAD | 0.5 | 0.6 | 0.9 | 0.5 | 1.0 | 0.8 |
| IDA | 38.5 | 36.5 | 32.1 | 28.6 | 13.7 | 25.6 |
| EC | 5.1 | 4.7 | 2.9 | 3.3 | 7.6 | 9.3 |

1. Introduction

- One of the constraints to aid delivery and its effectiveness is the high transaction costs, lack of co-ordination and lack of predictability of aid flows
- To overcome these two issues and other bottlenecks to aid delivery, the government of Ghana and 10 of its development partners have agreed on an aid package called the Multi-donor Budgetary Support (MDBS)

1. Introduction

- The MDBS has operated for over 3 years in Ghana but whether the MDBS has improved aid effectiveness remains to be investigated. Specifically,
 - o Can the MDBS significantly reduce transaction costs of aid?
 - o Not all donors have signed on to the MDBS, other forms of aid continue to exist. How will aid policies be harmonized under MDBS?
 - o These issues form the focus of the paper

2. Background to Multi-Donor Budgetary Support (MDBS)

- Budget support is a form of programme aid. Programme aid is an umbrella term covering budget support, debt relief, and balance-of-payments support
- Budget support may take two forms (i) general budget support, and (ii) specific budget support such as health and education

2. Background to Multi-Donor Budgetary Support (MDBS)

- Its main goal is to ensure a continuous flow of aid to enable the government to finance its poverty related expenditures.
- Unlike direct budget support, MDBS aims to harmonize policies and procedures of the development partners (DPs) in order to minimize transaction costs for the recipient country

2. Background to Multi-Donor Budgetary Support (MDBS)

- The framework memorandum (FM) was signed in March 2003 between the government of Ghana (GoG) and the DPs.
- Ghana's MDBS aims to minimize transaction costs for the aid recipient country (Ghana) by:
 - (i) agreeing on a common benchmark against which performance is assessed, (ii) improving dialogue between government and the development partners, (iii) conditioning funding commitments and disbursements on the achievements of the agreed targets.

2. Background to Multi-Donor Budgetary Support (MDBS)

- Framework to be based on Ghana Poverty Reduction Strategy Document and Medium Term Expenditure Framework
- The MDBS became operational since June 2003, has the MDBS made any significant in-roads towards reducing transaction costs and improving aid effectiveness?

2. Background to Multi-Donor Budgetary Support (MDBS)

- o The MDBS if properly planned, coordinated and well implemented—is likely to offer considerable benefits.
- o Possible benefits include: off-budget spending, using local capacity systems, reducing transaction costs, country ownership, donor influence and policy change, predictability of aid flows, pro-poor spending

2. Background to Multi-Donor Budgetary Support (MDBS)

Reduce Off-Budget Spending

- o defined as, 'below the line' expenditures of donor funds given to sector ministries of a country. These expenditures are not incorporated in the national budget and audited reports are not sent to the Ministry of Finance
- o Off-budget spending is common in aid-dependent countries, where a number of specific projects, especially within the health and education sectors are financed by donors through sector ministries. MDBS synchronizes aid flows and private flows - ie coordination

2. Background to Multi-Donor Budgetary Support (MDBS)

Use Local Capacity Systems

- o The MDBS is gaining popularity because it utilizes local systems and capacity, helping to build local potential. More often than not, governments are faced with an absorptive capacity constraint for project aid
- o MDBS, offers the opportunity to utilize the accounting systems of partner governments, encouraging staff to remain at their posts and strengthening local skills

2. Background to Multi-Donor Budgetary Support (MDBS)

Reducing transaction costs

- o Projects aid is often hindered by high transaction costs because submitting separate reports on a range of donor-funded projects is costly.
- o Also, the numerous meetings between government officials and donors can be time-consuming and significantly add to the cost of aid
- o MDBS – common reporting format, a single periodic report per project is sufficient to meet the requirements of all partners

2. Background to Multi-Donor Budgetary Support (MDBS)

Country Ownership

- o Project aid is generally made up of different projects funded by different donors. This often comes with very little country ownership and may not support the government's priorities
- o Johnson and Wasty (1993), assessed 81 adjustment credit cases and found ownership as very important
- o MDBS operates with Ghana Poverty Reduction Strategy document as framework. Note – **ownership** is not the same as

authorship

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2. Background to Multi-Donor Budgetary Support (MDBS)

Donor Influence & Policy Change

- o Donors want to influence the targeting of public expenditure towards the poor and at times towards more general economic and social reforms. Donors, therefore, use conditionality to influence policy change
- o there is little that donor conditionality can achieve if the willingness to take action is missing; conditionality then is superfluous and counter-productive because it undermines local ownership
- o Would donors be able to use their financial power to influence policy?

2. Background to Multi-Donor Budgetary Support (MDBS)

Predictability of Aid

- o Aid flows to developing countries are unpredictable and very volatile. There are diverse views on the effects of aid volatility on government's fiscal behaviour and growth
- o In Ghana, delays and shortfalls in donor inflows have forced the government to cut back on development expenditures.
- o At times, shortfalls have resulted in unplanned domestic financing or in non-concessional external borrowing, with serious repercussions on future budgeting

2. Background to Multi-Donor Budgetary Support (MDBS)

Predictability of Aid

| Years | Actual inflows | Projected inflows | Shortfall (%) |
|-------|----------------|-------------------|---------------|
| 1999 | 1275.0 | 1498.1 | 17.5 |
| 2000 | 2385.5 | 2978.9 | 19.9 |
| 2001 | 3739.4 | 3784.6 | 1.2 |
| 2002 | 2868.6 | 4706.3 | 39.1 |

2. Background to Multi-Donor Budgetary Support (MDBS)

Pro-poor Budget Spending

- o Projects aimed at poverty alleviation often have limited impact outside the project area and target group.
- o Budget support, which works hand in hand with dialogue, aims to re-shape the budget setting process in favour of the poor with better planned budgets, and ensuring that expenditures are related to resource availability and outputs

3. MDBS and Aid Effectiveness

- We use predictability of aid flows and harmonization of donor policies to access progress with MDBS
- Approach also involves looking at the trend in expected aid flows against realised outcomes (Predictability of Aid) in addition to a review of progress made on 'aid harmonization and effectiveness' under the MDBS

3. MDBS and Aid Effectiveness

- Almost 100% of funds pledged in support of Ghana's budget in 2003, 2004 and 2005 were fully disbursed (SGER, 2005:31)
- Increase in aid disbursements (flows) to Ghana between 2003-2005
- The decline in the share of aid through MDBS between 2004 and 2005

3. MDBS and Aid Effectiveness

| Actual Disbursements Projected Disbursements | 2003 - 2005 2006 - 2009 (US\$m) | Actual Disbursements | | | |
|--|------------------------------------|----------------------|---------------|-----------------|-----------------|
| | | 2003 | 2004 | 2005 | 2003-2005 |
| Total Disbursements: Actual and Projected | | 883.06 | 987.00 | 1,096.30 | 2,966.37 |
| IMF Support | | | | | |
| PRGF Arrangement (BOP support to BOG) | | 73.83 | 39.03 | 78.02 | 190.88 |
| Budget Support (MDBS) | | 264.30 | 310.91 | 290.59 | 865.80 |
| Credits | | 129.57 | 105.59 | 171.22 | 406.38 |
| Grants | | 134.73 | 205.32 | 119.37 | 459.42 |
| Sector and Investment Support | | 544.93 | 637.07 | 727.69 | 1,909.69 |
| Credits | | 172.82 | 224.33 | 240.85 | 638.00 |
| Grants | | 372.12 | 412.74 | 486.84 | 1,271.69 |

3. MDBS and Aid Effectiveness

| | 2003 | 2004 | 2005 |
|---|--------|--------|--------|
| Total Disbursement (\$ million) | 883.06 | 987.00 | 1096.3 |
| Share of MDBS in Total Disbursement (%) | 29.93 | 31.50 | 26.51 |

3. MDBS and Aid Effectiveness

- Decline in MDBS contributions between 2004 and 2005 from the World Bank, EU, Netherlands, UK. Most significant decline from the UK (66.6%)
- Significant proportion of aid is outside the MDBS basket – transaction costs have not been reduced significantly

3. MDBS and Aid Effectiveness (Foreign Inflows – Actual less expected)

| | 2002 (%) | 2003 (%) | 2004 (%) | 2005 (%) |
|--------|----------|----------|----------|----------|
| Loans | -102 | 27.67 | 23.61 | 5.3 |
| Grants | 28.79 | -6.78 | 47.1 | -9.2 |

3. MDBS and Aid Effectiveness

- Table above shows that loans rather than grants have been more predictable and most often higher than the budgeted figure.
- Also, there has been a rise in aid flows but not mainly due to MDBS
- Is the decline in the share of MDBS as a proportion of total disbursement between 2004 and 2005 due to donors' reduced interest in budget support?

3. MDDBS and Aid Effectiveness

- If MDDBS is key to ensuring aid effectiveness, why are donors delivering aid outside the MDDBS framework?
- The second major objective assessed is the **harmonization of donor policies**, which is key to reducing transaction costs and improving aid effectiveness

3. MDBS and Aid Effectiveness

- Extracts from the 'Ghana Harmonization and Aid Effectiveness Action Plan' shows that although plans are far advanced to reduce transaction costs, not much progress has been made in terms of outcomes.
- Many of the processes are partly implemented, under discussion or have just been initiated

3. MDBS and Aid Effectiveness

- Some examples include: Aid flows are aligned to national priorities (process initiated or on-going)
- Although donors agree to use Progress Assessment Framework (PAF) Matrix. FM allows DPs to do things outside PAF. Note that about 70% of aid is delivered outside MDBS
- DPs increasingly using Ghana's financial system for channelling aid flows (Done- agreed to use PEFA framework for country level monitoring. 10 out of 38 Ministries are using the public expenditure and financial management system

3. MDBS and Aid Effectiveness

- DPs increasingly use Ghana's public procurement system for purchase of goods, services and civil works using aid funds
- Reduction in tied aid
- Joint DP aid framework (moving towards a multi-year basis - **Done**)
- Number of joint missions increased and predictability of visits is improved (draft proposal shared with sector groups)

4. Conclusion

- The paper provides a preliminary assessment of the multi-donor budgetary support in Ghana in improving aid effectiveness
- The *multi-donor budgetary support* (MDBS), as it is called, might reduce transaction costs, take advantage of donor accounting systems to build local capacity, promote country ownership of policies and programmes, ensure pro-poor spending and above all make aid inflows more predictable

4. Conclusion

- Close to 100% of pledges under MDDBS have been disbursed. Aid predictability has improved since 2003
- MDDBS operates in tandem with other forms of project aid (70% of total aid). A common PAF does not exist for project aid and programme aid (MDDBS). The problem with this arrangement is that the mix would not reduce transaction costs significantly unless a common framework is used by all bilateral donors

4. Conclusion

- Study recommends that more aid be channelled through MDBS Framework while other sector supports are designed to have a unified reporting and accounting framework.
- Also, the activities outlined under the aid harmonization and effectiveness action plan should be carried through
- Finally, there should be a gradual shift from aid dependence but generate more resources domestically

END OF PRESENTATION

THANK YOU