Should budget support be discontinued?

Paul Collier

Once upon a time aid paid for projects: donors knew what their aid was buying. Gradually, donors faced up to the fact that this was a fairy story. If the project was good the government would most likely have done it anyway, so what the donor was really financing was whatever the government chose to do with the money now freed up. Since donors were really financing a share of the government’s general spending, it was better to be upfront about it: ‘budget support’ was born. Budget support was initially used as the carrot for policy conditionality: donors negotiated policy ‘reforms’ as the price which governments had to pay for it. Policy conditionality has rightly gone out of fashion: if donors purchase policies, they, rather than governments, should be accountable to citizens. But in retreating from policy conditionality, donors found themselves in an uncomfortable position: the judgment that aid was well-used rested on little more than an act of faith in recipient governments. In their hearts, donors seldom have such faith and so they are having second thoughts: the European Commission, a major source of budget support, is publicly consulting on whether it should be discontinued.

Donors have undoubtedly distributed budget support to governments for which it has been ill-suited. Such aid only makes sense if two hurdles are jointly satisfied, one political and the other technical. The political hurdle is that the government should manifestly be trying to benefit its citizens. The technical condition is that the government sits atop a secure process of public spending: money gets used only for what parliament has approved. Where these hurdles are satisfied, donors should indeed keep out of the kitchen: the government is best-equipped to determine how aid should be spent, and even its mistakes are learning experiences. Donors routinely make the necessary judgments regarding the first hurdle. But the technical hurdle requires a judgment that they often duck: money is repeatedly fed into leaky budget processes. Such leakages are not merely wasteful: the money is captured by the very people who are at the core of the problem. Donors duck this judgment because they lack both the necessary access to information and the necessary technical skills. They also have an incentive not to look too closely. Budget support is bureaucracy’s nirvana: large amounts of money can be disbursed on schedule with low overheads.

Yet that second hurdle matters: an independent process of scrutiny is needed to certify public spending systems as being fit for budget support. The obvious agencies to provide certification would be the IMF and the World Bank in tandem: both already assess different aspects of the budget process, but neither are these assessments combined, nor does either agency expose itself to a judgment. What would certification achieve? Those countries that gained certification would have a much stronger case for budget support. Those that didn’t could have a grace period to get their systems in order, supported by technical assistance, failing which budget support would be tapered out. Presidents would likely pressure their governments into doing what it took to achieve certification. Would this be a backdoor return to policy conditionality? Decidedly not: the purpose is not to tell governments on what to spend their money, but to ensure that their own laws are enforced. Nowhere is looting of the public purse an official policy.
One reason why donors are wary of certification is that ‘fragile states’ would clearly not meet any reasonable standard. Yet without a budgetary infusion there is a risk of state collapse. The rationale for support here is not ‘budget support’ but rather ‘life support’: to avert the staggering costs of state failure. Life support can make sense, but donors should handle it entirely differently from budget support. The use of the same vehicle for the two situations has both exemplified and deepened donor confusion: if fragile states are eligible for budget support, every country is eligible. Once fiscal support in these situations is distinguished as ‘life support’ the rules of engagement can also be distinguished. Life support should come with sufficient imported administrative capacity immediately to achieve proper standards of public spending, not just of donor money but of all public money (donor spending cannot, in reality, be separately identified). Unlike technical assistance to prepare for budget support, the core objective of imported administrative capacity would not be to build local capacity, but to prevent public money from being looted by political crooks. As Paddy Ashdown said of Bosnia, what was needed was not ‘doctors without frontiers’ so much as accountants without frontiers.

A further reason donors are wary of certification is that in some countries public spending systems are so badly broken that they cannot be rectified in the time-scale dictated by social needs. Yet these countries often have a more acute need for money than those where the public sector functions. Here Tinbergen, the great Nobel Laureate in economics, provides a key insight. For a given number of objectives to be achievable there must be at least as many instruments with distinct effects. Donors have been trying to achieve at least two objectives – meeting social need and spending aid effectively – with the single instrument of the volume of aid that a country receives. Failure is inevitable as donors lurch between an aid allocation which favours one objective and one which favours the other. Since neither objective can be abandoned, donors must develop a second instrument: variation in the modalities by which aid can reach needs. A reversion to project aid would bring only illusory comfort. Donors should experiment with innovative types of organization, perhaps hybrids of public agencies and social enterprise, which provide coordination, accountability and equity without placing unrealistic demands on the public sector.

Budget support indeed needs to be rethought. But the principle that those governments of poor countries that are decent and competent should be empowered by aid rather than pestered remains valid.

Paul Collier is Professor of Economics at Oxford University