

How Can Donors Promote Budget Transparency and Accountability? The Use of Benchmarks and Incentives for Budget Transparency in Foreign Aid Programs¹

Donor agencies are showing an increased interest and commitment to promoting budget transparency and accountability in countries to which they provide assistance. While donors can play an important role in this regard, they also need to avoid the pitfalls associated with the past use of conditionalities. They should encourage recipient governments to open up their books and build the capacity of accountability actors to use available budget information, but do so in a way that does not impose quick-fix solutions and promotes the involvement of various domestic stakeholders. This note puts forward some basic principles that donors interested in promoting a more effective approach to improving budget transparency and accountability could adhere to. These principles are:

- a) budget transparency benchmarks and incentives should be transparent, adapted to country context, and founded on country-based dialogue;
- b) budget transparency benchmarks and incentives should include both minimum standards and a graduated approach to promote improvements;
- c) budget transparency benchmarks should be linked to positive incentives aimed at promoting budget transparency; and
- d) the use of budget transparency benchmarks should be linked to donor improvements on aid transparency, and coordinated among all donors.

The proposed principles are not an argument in favor of the application of transparency-related conditionalities by donors, but rather the outline of an approach that donors that are already considering the option of including transparency benchmarks and incentives in their aid programs could follow.

Background

Transparency is increasingly recognized as an important characteristic of well-governed societies, and as a precondition for improved accountability and development outcomes. As a result, donor agencies have started putting more emphasis on the need for developing countries to introduce reforms aimed at improving transparency and public access to information in government matters. One example of this trend is the fact that donor agencies wanting to channel aid funds directly through government systems (e.g., through direct budget support or sector programs) increasingly require recipient countries to meet minimum standards of budget transparency.

¹ For more information, contact Vivek Ramkumar, IBP Director of International Advocacy and the Open Budget Initiative, at vramkumar@internationalbudget.org or Alan Hudson, ONE Policy Director (Transparency & Accountability), at alan.hudson@one.org.

The need to establish transparent public financial management systems in countries receiving aid was also clearly stated in the declaration coming out of the 4th High-Level Forum on Aid Effectiveness held in Busan (South Korea) in late 2011 and endorsed by more than 100 governments and international institutions.² Earlier in the same year, former World Bank president Robert Zoellick declared that the Bank “will not lend directly to finance budgets in countries that do not publish their budgets” (speech at the Peterson Institute, April 2011).³ This was followed by a Guidance Note detailing how Bank country teams should take budget transparency into account when designing so called Development Policy Operations (DPOs), the Bank’s budget support instrument. More recently, in 2012, the European Commission included a budget transparency-related benchmark for countries to qualify for EC budget support.⁴ A similar benchmark already existed in the U.K. DFID’s budget support guidelines (and was included in the U.K.’s commitments made as part of the Open Government Partnership).⁵ U.S. law currently requires that U.S. foreign assistance to central governments be provided only to countries that meet minimum standards of fiscal transparency.⁶ Finally, transparency and accountability also have become important benchmarks for global sector initiatives such as the UN’s Global Strategy for Women and Children’s Health, where both donor and recipient countries have made specific pledges to be accountable for resources invested in maternal and child health.

All of the above indicates that budget (and fiscal) transparency is increasingly becoming an area of interest for donor agencies interested in promoting better governance standards and domestic accountability in recipient countries, while at the same time ensuring that adequate safeguards are in place to guarantee that aid funds are spent effectively and not wasted through mismanagement and corruption. Given the complexity of the debate around aid, governance, and development, it is important to establish some basic principles to guide the ways in which benchmarks and incentives are designed and used by donor agencies to promote greater budget transparency in countries receiving foreign aid. This paper discusses and puts forward four such principles that could be used to promote dialogue among various actors around the role of donors in promoting transparency and accountability in fiscal matters. The proposed principles are not meant as an argument in favor of the blanket application of transparency-related conditionalities by donors across the developing world, but rather as the outline of an approach that donors that are already considering the option of including transparency benchmarks and incentives in their aid programs could follow.

The pros and cons of budget transparency benchmarks and incentives

The lack of transparency on how governments use public resources is a key constraint around the world for civil society, the media, legislatures, and audit institutions in holding governments accountable. Public availability of fiscal information is a prerequisite for accountability in public finance management. Moreover, in a number of low-income countries, domestic civil society organizations often lack the capacity and resources to mobilize public opinion around demands for greater budget transparency. The few voices that exist are often marginalized by government resistance to open up its operations to public scrutiny. While reforms promoting domestic accountability inevitably need to be supported by a range of local actors in order to take root and

² See http://www.effectivecooperation.org/files/OUTCOME_DOCUMENT_-_FINAL_EN2.pdf.

³ See: <http://www.piie.com/publications/papers/paper.cfm?ResearchID=1802>.

⁴ See http://ec.europa.eu/europeaid/how/delivering-aid/budget-support/documents/bs_guidelines-part_i_executive_guide_en.pdf.

⁵ See <http://www.dfid.gov.uk/Documents/Strengthened-approach-budget-support-Technical-Note.pdf>.

⁶ See <http://www.gpo.gov/fdsys/pkg/BILLS-112hr2055enr/pdf/BILLS-112hr2055enr.pdf> (see section 7011 (b), page 425-6).

result in sustainable impact, donor agencies providing development assistance to the government can play an important role in creating more favorable conditions for domestic accountability. This is especially true in countries that are highly aid dependent, where donors finance a large share of public spending. In fact, in a number of aid-dependent countries, civil society actors see donors as potential allies in the struggle to get governments to open up their books.

There are a number of ways in which bilateral and multilateral donor organizations can affect budget transparency and accountability in aid-recipient countries. They can provide incentives that encourage governments to make budget information publicly available, for example, by committing to channel more of their aid directly into the government budget in countries where budgets are more transparent, or by demanding that specific transparency benchmarks are met before aid funds are disbursed. Donors can also provide technical assistance and funding to support the introduction of comprehensive information systems that allow governments to produce accurate and timely budget information, or the creation of information disclosure systems that facilitate the dissemination of fiscal and service delivery information to the public. Furthermore, they can support the efforts and build the capacity of domestic accountability actors (legislatures, audit institutions, civil society, and the media) in demanding that their governments disclose fiscal information, and in making better use of existing fiscal information to hold the executive accountable. Finally, donors can be more transparent themselves about the aid they provide. Aid transparency and budget transparency are inextricably linked. Budgets in partner countries cannot be made fully transparent without improved aid transparency. Only if donors provide partner countries with sufficient information, compatible with partner country budget systems and schedules, can timely, accurate and comprehensive budget information be made available to citizens of countries receiving aid.

One of the main concerns with the use of benchmarks and incentives in aid programs comes from the dubious track record of the use of conditionalities more generally. Existing evidence on their past use highlights a series of shortcomings. Conditionalities have been criticized for being negotiated behind closed doors by a small number of donor and government officials, for distorting domestic policy processes, and for undermining domestic ownership through the imposition of “one-size-fits-all” models drawn from foreign experience, which ultimately do not work. These characteristics undermined the legitimacy of any reforms upon which aid was conditioned, prevented the formation of domestic reform constituencies, and limited governments’ commitment to reform implementation, rendering the aid conditionalities mostly ineffective at spurring meaningful and sustainable institutional and policy changes. As a consequence, many in the past have been quick to label all conditionalities as “wrong” and “ineffective.”

This line of argument needs to be carefully taken into account in the design of principles that could guide the introduction and use of budget transparency benchmarks and incentives, in order to avoid the pitfalls of past attempts at imposing specific reforms and practices on aid-dependent governments. Two additional issues should be taken into account in this regard. First, the international politics of aid relationships have changed dramatically since the times in which donors were able to impose structural adjustment reforms on cash-strapped poor country governments. Nowadays, donor agencies have shifted, at least rhetorically, to a different approach based on more flexible dialogue and partnership, and aid-dependent governments are in a better negotiating position *vis-à-vis* donors, given their better fiscal conditions and the existence of alternative sources of financing, such as natural resource revenues or aid from emerging powers. Second, it could be argued that benchmarks and incentives aimed at promoting budget transparency can in fact open up rather than prevent possibilities for domestic debate and dialogue on different policy options, encouraging governments to engage with a range of accountability actors. Evidence from case studies commissioned by the International Budget Partnership shows how, in countries like Honduras and Afghanistan, donor pressure to improve budget transparency led to improved

dialogue between the government and domestic civil society organizations.⁷ Donors promoting budget transparency along these lines may make a lot more sense than most past uses of conditionality, even though the impact of their efforts will vary from country to country.

The key question is not whether conditionalities – or budget transparency benchmarks and incentives for that matter – are right or wrong, but rather how donors interested in promoting budget transparency in aid-dependent countries can use these tools in a way that promotes (and does not undermine) domestic dialogue and accountability processes around public finance management, and that maximizes their chances of positive and sustainable impact.

Proposed basic principles for the use of transparency benchmarks and incentives

Based on the discussion above, the following set of principles should be adopted by donor agencies interested in the use of benchmarks and incentives to promote improvements in budget transparency in countries they support. They are based on lessons learned from past use of conditionality, and from an emerging consensus in the budget transparency and accountability field. However, as they have not yet been applied in practice, they should be seen as an emerging approach in need of further testing and refinement. It is also important that they are seen as a package, as they are more likely to be effective if adopted together.

1. *Budget transparency benchmarks and incentives should be founded on country-based dialogue, developed and monitored in a transparent manner, and adapted to country context.* In order to ensure that transparency benchmarks and incentives are more effective, and to avoid the pitfalls of past use of conditionalities, donors should engage in meaningful dialogue with a broad spectrum of country-based actors, including civil society, legislatures, and audit institutions, in order to help them articulate their needs and priorities in terms of what types of budget information is most needed, and have these reflected in donor programs. Such dialogue needs to happen at the right stages of the aid negotiation process, so that its results can be incorporated in aid agreements. Donors and recipient governments should make information about the process through which benchmarks and incentives are identified publicly available through adequate means, and create opportunities for participatory monitoring and evaluation of the implementation of agreed reforms, thus opening up spaces for domestic dialogue and debate. Finally, donors should refrain from actively promoting specific types of transparency reforms, but rather provide assistance in the identification of models that better fit country circumstances, priorities and capacities, for example, based on a menu of options that domestic actors can choose from.
2. *Budget transparency benchmarks and incentives should include both minimum standards and a graduated approach to promote improvements.* Transparency benchmarks and incentives can take the form of minimum standards that countries must comply with in order to qualify for aid (or of specific types of aid flows), or of a country-specific set of measures aimed at improving levels of budget transparency over time. Minimum standards that apply across countries suffer from an inherent contradiction. Either they are set too high and, therefore, limit the number of countries that can receive aid (as in the case of the Millennium Challenge Corporation, which was designed to give aid only to well-performing countries), or they are set too low to ensure that the largest possible number of countries qualify (as in the case of World Bank and EC guidance on budget support operations), losing their incentive function. While a minimum standard (i.e., a minimum set of budget documents that most countries need to produce) does make sense (see Appendix 1 for suggested minimum standards), provisions should be made to ensure that assistance is provided to countries falling below such minimum standards so that

⁷ See http://internationalbudget.org/ibp_publication_categories/budget-transparency/.

they can gradually comply. A gradual and flexible approach, again linked to country context, should be adopted to encourage recipient governments to commit to and achieve sustainable transparency improvements over time. Beyond minimum standards, further benchmarks could be linked on one hand to the government's capacity to produce more and better quality budget information, and on the other hand to a commitment by donors to provide more aid as direct financing of the recipient country's budget.

3. *Budget transparency benchmarks should be linked to positive incentives aimed at promoting budget transparency.* Simply asking governments to meet certain budget transparency benchmarks is likely not to be very effective by itself. Benchmarks should be linked to positive incentives for recipient governments to improve their budget transparency practices (such as the provision of an increasing share of aid through government systems). Benchmarks should also be coupled with technical assistance and financial support to build capacity both within the executive, for the production and dissemination of budget information, and within other organizations, such as legislatures, audit institutions, civil society, and the media, whose job it is to demand budget information and use it to hold governments accountable. Specific initiatives could include drafting or revising budget legislation with the aim of providing a legal basis for budget transparency, but also working with different sets of actors to ensure that legal provisions are consistently implemented. This could help build a broader domestic constituency for budget transparency and improve the links between improved transparency and enhanced accountability.
4. *The use of budget transparency benchmarks should be coordinated among all donors and linked to improvements in aid transparency.* Donor agencies within each country should adopt a coordinated approach to the use of transparency benchmarks and incentives. Of course, this is more easily said than done. The existence of internationally recognized methodologies for measuring budget transparency, including the Open Budget Index, could be used to facilitate dialogue and reach consensus. Moreover, donors' requests for recipient countries to publish more budget information should go hand-in-hand with donor commitments to improve the transparency of their aid flows, so that those in turn can be adequately captured in the recipient countries' budget processes and reports. The use of the standards being developed as part of the International Aid Transparency Initiative is particularly relevant in this respect.

The application of the principles identified above could serve to promote a more constructive – and potentially more effective – approach to opening budget systems in developing countries to public scrutiny, and to foster an environment in which public debate and accountability on fiscal matters can flourish. For donors interested in promoting the cause of fiscal transparency and participation, the application of the principles could be adapted and tailored to existing policies, priorities, and aid portfolios, helping to write a new chapter in multistakeholder collaboration in support of deeper and more sustainable governance reforms.

Appendix 1

Proposal for minimum standards on budget transparency and participation:

- a) All governments should be expected to publish at least four of the eight key budget reports indicated below during the course of the national annual budget cycle. These are the Executive's Budget Proposal, Enacted Budget, Year-End Report, and Audit Report (see below for a description of these reports). These budget documents are referenced in existing international norms and guidelines on fiscal transparency.

- b) All governments should be expected to organize public hearings at which citizens and a broad range of civil society actors are invited to participate during budget planning and evaluations. These mechanisms should be jointly developed by the executive (Ministry of Finance or lead budget agency) and the national legislature.

These standards should be revised periodically on a country-by-country basis to promote a graduated approach to budget transparency improvements. This is based on the expectation that governments should take gradual steps to: a) publish the rest of the eight key budget reports – and additional fiscal reports (such as financial statements, Pre-Budget Statements, and Mid-Year Reviews); b) provide more comprehensive budget information in budget reports already published (as recommended by various public financial management standard-setting bodies); and c) implement more widespread mechanisms for public engagement in budgeting, including providing citizens with information on how the inputs and feedback presented during public hearings were utilized. The main aim is to encourage continuous improvements in fiscal transparency and participation.

Eight Key Budget Documents that all Governments Should Publish

1. **Pre-Budget Statement:** report that identifies the assumptions used to develop the budget, such as total expected revenue, expenditure, and debt levels, and broad sector allocations.
2. **Executive's Budget Proposal:** presents the government's detailed declaration of the policies and priorities it intends to pursue in the upcoming budget year, including specific allocations to each ministry and agency. This document should be published simultaneously with its submission to the legislature.
3. **Enacted Budget:** the legal document that authorizes the executive to implement the policy measures contained in the budget proposal and related amendments. This document should be published within three months of the budget being approved by the legislature.
4. **In-Year Reports:** monthly or quarterly reports on revenues collected, expenditures made, and debt incurred. These documents should be published within three months after the end of the reporting period to which they refer.
5. **Mid-Year Review:** report which summarizes the actual budget data for the first six months of the year (revenues, expenditures, and debt), reassesses the economic assumptions upon which the budget was initially drafted, and adjusts the budget figures for the remaining six months accordingly.
6. **Year-End Report:** statement summarizing the financial situation at the end of the fiscal year, and an update on progress made in achieving the policy goals of the Enacted Budget. This document should be published within one year of the end of the budget year to which it refers.
7. **Audit Report:** report issued annually by a body that is independent from the executive, covering all activities undertaken by the executive. This document should be published within two years of the end of the budget year to which it refers.
8. **Citizens Budget:** simplified summaries of some or all of the seven budget documents discussed above, issued in languages and through media that are widely accessible to the public. This document should be published at the same time as the budget document to which it refers.