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Budget aid - does it help to improve development cooperation? Rwanda - a case in point

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In the past years, budget aid has become a developmental instrument of relevance in a variety of partner countries. In this context it is important that the debate on the use of budget aid does not apply to instrumental aspects alone but is primarily connected to the debate about aid effectiveness.

Against this background Rwanda for many years has been one of the countries that expect their development partners to substantially reform their approaches. Rwanda perceives the donors' inclination towards genuine reforms to be rather hesitant and, in many cases, disappointing. Other partner countries definitely share this view as well.

These expectations go back to the Paris Declaration of 2005, which has now been updated further by the Accra Agenda for Action (AAA). Rwanda was one of the most important protagonists of the AAA; among other involvements, the country is actively working in an international initiative aimed at improving the transparency of development cooperation[1].

Rwanda's own 2006 Aid Policy formulates a clear strategy for the donors in which the government - in conformity with the Paris Declaration - declares general budget aid to be its preferred form of cooperation. Moreover, the government urges partners to swiftly implement the obligations formulated in the declaration in other areas - something that does not always appear to be easy for the donors to do, for instance in the "hard indicators" such as 'using Rwanda's procedures' (such as procurement systems) or 'on-budget' aid[2] - that is, aid that becomes part of the regular budget and is therefore transparent for the partner side. Despite all donor rhetoric, conducting joint missions aligned with the rhythm of the partner country is not at all an obvious thing to do for all donors. For this reason the government wants to move away from a system that contains many "project islands" and donor approaches that require an enormous coordination effort, are hardly cost-effective and, above all, tend to produce unsatisfactory outcomes.

Despite various weaknesses and challenges Rwanda over the past years has put in place a generally successful poverty reduction policy, and given the regional setting this is all but self-evident. Rwanda's basis for reform is now the country's second EDPRS (Economic Development and Poverty Reduction Strategy). In this strategy the government relies both on actively supporting social areas and on strengthening the productive sectors to achieve economic growth.

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[1] International Aid Transparency Initiative (IATI).

[2] See current study by Mailan Chiche (Putting Aid on Budget: A Case Study of Rwanda, Mokoro Ltd, Oxford 2008), which discusses the differences between various forms of "on budget" aid. For example, it makes a big difference whether financial cooperation measures are merely recorded in specific reports or whether the country (particularly the parliament) can actually structure and control the budget, including the available ODA funds.

The government has ambitious goals. Its initial goal of bringing Rwanda into the middle-income group of countries by 2020 is likely beyond reach. Nevertheless, rapid progress in reducing poverty (only 46% of the population is expected to live below the poverty line by 2012) and high economic growth rates (from 6.5% in 2006 to 8.1% in 2012) remain declared objectives. To be able to achieve these objectives the government is relying on (a) raising agricultural productivity, (b) greater contributions from the manufacturing sector, and (c) making better use of service sector opportunities (including information technology and tourism).

Rwanda has achieved visible progress in reducing poverty, but more has to be done. It has succeeded in reducing the share of people living in poverty from 65% in 2000 to 56% today, and in greatly improving some social indicators like under-five mortality (from 152 per 1000 live births in 2005 to 103 in 2008), malaria prevalence and school enrolment rates. The economy is growing at a favourable rate of 6% (2007). However, the country still faces enormous problems as 37% of the population still lives in extreme poverty. Income inequality is rising (the Gini coefficient rose from 0.47 in 2000 to 0.51 in 2006). In addition, high population growth of 2.7% and high inflation (9.7% in 2007) has prevented many achievements from generating sufficient results. Crises such as the one in Kenya have a particularly strong impact on Rwanda, where transport costs account for around 40% of import and export prices. The lack of alternative income sources other than subsistence farming combined with particularly high population density are major challenges for the country's policies and economy. Finally, and not least, making the country more open to democratic policies is a relevant concern.[3]

With great development challenges remaining and the country pursuing a wholehearted reform policy, the Rwandan partners' interest and demand to use development cooperation as cost-efficiently and effectively as possible is a legitimate concern. On the basis of the experience Rwanda has gained with budget aid so far, the following aspects are of relevance:

- *For the foreseeable future, the Rwandan government will remain dependent on external support to implement its reform policies.* Clearly, there is a particularly strong sense of ownership - or responsibility - in Rwanda with regard to budget aid, and not only on the part of the government but of parliament as well. As the country is still reliant on external support the government underscores time and again that budget aid carries benefits and prevents problems of isolated projects that result from the large number of donors (such as high costs of projects running outside the regular structures and services that are too expensive and often tied to supplies).These problems range from the enormous amount of time required by the government just for attending missions to difficulties a government may encounter in planning its own budget rationally because of donor procedures, which are foreign to the national planning and implementation methods.
  For the Rwandan partners the use and support of national structures is the main aspect of budget aid as it precisely does not support diverse donor approaches but focuses on direct implementation of its own national poverty reduction policy and on developing its own capacities.

  The limited capacities of the Rwandan structures are precisely what budget aid donors are very much concerned about. "Lean" management of budget aid, which is increasingly being harmonised between the donors, is an important contribution towards easing the strain on Rwanda's administration.

  The difficulties standing in the way of more efficient and effective DC can be described on the basis of the following example: it is almost impossible for the government to plan with DC funds Rwanda receives outside the national budget, many of the separate DC budgets

[3] See the analysis "Joint Governance Assessment", which was commissioned jointly by the development partners and the Rwandan government, was completed in July 2008 and is set to be published in autumn 2008.

are nontransparent (e.g. how much money is being spent on staff?), they are not necessarily subject to tendering regulations and therefore are often excessively costly, which is why they are ultimately less effective precisely because they are not systematically part of the partner country's methods. How can a government be expected to plan reasonably if more money is invested in some sectors outside the national budget than through the corresponding sector budget lines?[4] Thus it is not without reason that the Rwandan government is complaining that the share of development cooperation funds flowing through the budget has hardly improved from 2005 to 2007 although the donors committed themselves to this in the Paris Declaration (for Rwanda: from 49% to 51% - a quota of 74% is to be reached in 2010). This criticism was confirmed by the 2007 analysis of budget management (PEFA/Public Expenditure and Financial Accountability). This analysis not only surveys 28 indicators on the capacity of the Rwandan side but also three indicators that relate to donor behaviour and their influence on the relevant budget system. The donors received the poorest mark of "D" on two counts because both the inadequate financing information about their development cooperation projects and programmes and the inadequate use of national procedures put a strain on the public budget management system.

- *Budget aid is important in Rwanda because it actually makes implementation of Rwanda's poverty reduction strategy possible*; that is, without budget aid Rwanda would have to accept great limitations in the realisation of its poverty reduction and reform policy. In 2008 around 20% of the budget will be financed by way of budget aid (around USD 196 million in general budget aid). Sector budget aid contributions of roughly USD 116 million will be added. The 2008 budget provides for RwF 623 billion in total, or the equivalent of EUR 780 million.

  The group of donors in Rwanda is still small - the seven donors today include: IBRD (2008: USD 70 million), DFID (Great Britain) (USD 61 million), EU Commission (USD 24 million), African Development Bank/AfDB (USD 19 million), SIDA (Sweden) (USD 11 million), Germany (USD 7 million) and the Netherlands (USD 4 million). In 2007 Germany joined the group of budget aid partners. Germany is also starting to carry out DC with sector budget aid in the health care sector, and the Rwandan side also counts Germany's financial contribution to the local investment fund (CDF/Common Development Fund) as sector budget aid.

  The IMF also operates in the group alongside the seven budget aid donors. Cooperation in the budget aid donor group is intensive and the IMF, for example, also opens its missions to budget aid donors as observers. The IBRD is also open to concerns voiced by members of the budget aid donor group - such as KfW Entwicklungsbank, which implements Germany’s budget support programmes. In other words, Germany closely coordinates its work with the group, so it has visible scope for influencing the design of overall budget aid. One element of this influence is that KfW Entwicklungsbank emphasises the consideration of aspects relating to public financial management, especially at the decentralised level.

- *Within the framework of budget aid, an intensive and openly critical dialogue is being conducted with regard to the reform policies;* the participating donors can conduct a constructive debate about the architecture of policies with a self-confident partner country. This takes place in the so-called Joint Budget Support Reviews (JBSR) every 6 months, but also in numerous forums between these reviews. In Rwanda budget aid is the central instrument of dialogue on poverty reduction policy.

  The fact that the social sectors are increasingly focusing on basic services and on structuring the budget management (public debate about budget priorities, strengthening accountability etc.) at the national and local level is very much a result of the dialogues held on

[4] For example, donor funds invested in Rwanda's health care sector outside the budget significantly exceeded the actual funds of the health care sector itself.

budget aid. The increasing involvement of parliament in the budget process and the strengthened function of the Rwandan Office of the Auditor General, which plays an independent role, are also directly related to budget aid.[5]

KfW Entwicklungsbank, for example, encourages budget aid donors to meet regularly with the parliamentary budget committee, and it invites the Office of the Auditor General to discuss its critical results with the donors as well. In the future, budget aid can be used even more intensively as a vehicle for the concerns of civil society. For example, when tracking studies are made by civil society, budget aid donors can provide a forum in which to discuss their results.

- *For budget aid donors, transparency and public finance management are central themes in Rwanda*. Improved financial management contributes significantly to making policy action more transparent overall for the population and encourages public debate. Although challenges in this field remain, Rwanda is clearly making progress in its management of public finances. Given the very dynamic decentralisation policy and the growing financial transfers to the districts that result from it, the local level is becoming increasingly important. Budget aid makes a relevant and immediate contribution to advancing the decentralisation process.

  Budget aid creates the preconditions for the entire budget cycle and its individual components to be subjected to comprehensive and independent supervision.[6] The PEFA study on budget management mentioned above, for instance, shows that considerable weaknesses remain; but the progress made in this area in recent years is respectable.

  The following is an example of German participation in the consultation rounds in the group of donors and with the government: the PEFA analysis has dealt with the entire budget cycle. A further step is now under preparation to create additional analytical competencies. Public Expenditure Reviews are being performed under the coordination of the IBRD for all relevant policy areas. Germany's budget aid is working to integrate the local level adequately into this process. It will therefore contribute, amongst others, relevant partial studies - so-called tracking studies - about the revenues side of the districts and the expenditures of the investment fund at the local level (CDF), which is crucial to the entire local social and economic infrastructure.

  Budget aid donors always pay great attention to the management of public finances. So with a view to this as well, it is important for the government to move away from individual donor support measures and instead to make use of the existing common mechanism (basket funding). It is not the individual donor with their "own project" and their own staff that the government wants but a coordinated financial contribution and policy dialogue so that the Rwandan strategy can be directly implemented.

- Finally, what is of interest is *how budget aid correlates with Rwanda's own revenues*. The Rwandan government emphasises that it actually regards development cooperation as only a phase of transition for the country until its own economy is strong enough to provide a basis for revenues of its own.

  Considering the country's enormous problems, however, it is realistic to assume that Rwanda will remain dependent on external support for some time to come. This is just why it is important to work directly towards preventing development cooperation and budget aid from creating false incentives. Accordingly, budget donors are concerned about how the revenue situation in particular will develop. Especially over the past years, efforts directed at improving the revenue side have produced good results. Tax revenue of now 15% of

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[5] For more on the important link between new DC approaches and their impact on good governance, see the Final Synthesis Report on a comprehensive research project conducted by David Booth/Verena Fritz, "Good governance, aid modalities and poverty reduction: From better theory to better practice", 2008.

[6] This point is also underscored by the British National Audit Office in its report on budget aid: National Audit Office: Providing budget support to developing countries, London 2008.

GDP or around 44% of the 2008 national budget is a noteworthy political achievement for Rwanda.

From the viewpoint of the Rwandan government, budget aid is being pursued as a priority for the reasons set out above. From a donor perspective, an argument in favour of applying this instrument in Rwanda is that the implementation of meaningful reform and poverty reduction policies is immediately apparent.

Considering how serious the Rwandan government has been about putting its reform policy into place, it has good arguments for expecting the development partners to carry out as effective and efficient a development cooperation as possible. Moreover, the Paris Declaration and the Accra Agenda for Action provide clear and comprehensible appraisal standards and internationally acknowledged principles which apply to development cooperation and to the lead role of the partner government.