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# **BUDGET SUPPORT AND AID COORDINATION IN TANZANIA**

Report presented to the Norwegian Embassy in Dar es Salaam

Dag Aarnes

## **CONTENTS**

1	Summary .....	2
2	Development of new aid modalities in Tanzania .....	3
3	Outline for a new Approach in Tanzania .....	9
	Appendix 1 Expected Outcomes of General Budget Support.....	13
	Appendix 2 Practical Implementation – the Checklist Approach .....	16

# 1 Summary

This report is an input in the planning process for Norwegian development cooperation with Tanzania. The objective is to advise the Norwegian Embassy in Tanzania on the issue of expanding poverty linked budget support as a share of overall development support. Norway has indicated its willingness to move towards additional budget support and reduce its support to key reforms in order to harmonise and reduce the burden for GoT in handling development assistance. The aim of this would be to contribute to reduced transaction costs for the Tanzanian government, improved aid coordination and support the development of a better planning and budget process in Tanzania. After the Helleiner Report in the mid 1990'ies significant progress has been made in designing and coordinating aid modalities and maintaining the dialogue between Government and development partners. However, there are still significant challenges after 10 years of active work in this area.

Government representatives in Tanzania feel that there has been an implicit promise from donors of a switch to budget support that is not materialising. The reason for this is that Tanzania has delivered reforms in many areas and has achieved very good and consistent results. They were under the impression that this would be 'rewarded' by donors by less earmarking of the aid. However, many donors still maintain their complicated set-up of programme and projects interventions in spite of having a stated policy of expanding budget support when conditions were right.

The process overload issue is therefore largely unresolved. According to the 2004 World Development Report, Tanzania is in active dialogue with more than 50 aid organisations that send more than 1 000 delegations and ask for more than 2 000 reports each year. Even in a country of amazing hospitality this is beginning to strain relations. It is costly and time consuming, and probably steals resources from the activities donors are asking for more of: quality budget, and planning work and poverty monitoring.

Both sides in the dialogue want to work towards significant improvements in the budget process. Many development partners argue that better budgets could be the result of improved techniques of collecting and analysing data of aid flows and inserting them in the budget. This view is increasingly being contested by Tanzanian officials who argue that only general budget support funding has a chance of being fully included in the budget process and voted over in parliament. Research into this issue is increasingly coming to the conclusion that fragmented and large scale aid is a major part of the problem of non-functioning budget processes.

The results of the SWAP's in Tanzania do not appear to be very convincing. Tanzania has a reasonably good public accounting system and relatively detailed tracking of resources is carried out in the Public Expenditure Reviews (PER). The PERs show that resources are fungible and that the SWAP sector dialogue is unsuccessful in achieving higher over all allocations for the sector. The dialogue is also usually mostly concerned with the same cross cutting issues as the overall macro dialogue. One of the most important reforms in Tanzania at the moment is the establishment of a decentralised system of service delivery supported by a formula based system of transfer of resources to local government from the central budget. The many area based programmes run by donors are working directly against this.

There is an increasing interest in supporting Tanzania and probably declining overall need for development assistance. This could lead to a situation where Tanzania actually chooses to decline offers of aid that is seen a contrary to the country's budgeting and planning procedures. This would mean that the main challenge now is to develop the PRBS/PRSC into an even better dialogue tool and aid modality.

## 2 Development of new aid modalities in Tanzania

During the last 10 years there has been a significant shift from project aid to SWAPs<sup>1</sup>, and now increasingly from SWAPs to budget support in Tanzania. The process started when a group of independent advisers on development co-operation issues submitted a report regarding improvements in the cooperation between the Tanzanian government and the development partners (called the Helleiner report after the chairman of the group). This led to the adoption of the Agreed Notes in January 1997 that set in motion the process for building a new relationship. The Helleiner report offered a list of recommendations with respect to ownership, partnership, responsibilities of the Government of Tanzania (GoT) such as civil service reform, budget reform, improved economic management, social sector strategy and action on the problems of corruption. The recommendations implied radical changes in the relationship between the donors and the GoT in order to enhance the effectiveness of foreign aid. The report highlighted the following main issues:

- GoT must be in charge of the policy process and the practical way to ensure that would be to insist the government should prepare all policy documents and submit to donors for comments.
- Development partners should withhold or delay aid until the local conditions necessary for ownership are satisfied.
- There is an urgent need to shift from the existing situation of an uncoordinated proliferation of projects to a more rationalized and focused program.
- Individual donors country programs must be harmonised with Tanzania's own prioritization of projects.
- Tanzania needs a vision for long-term development and to draw up supportive strategies and investment programs
- There must be full disclosure of committed donor resources for the purposes of proper budgetary planning
- There is need for a plan of gradual decline in external support for Tanzania

The Helleiner report was followed up in a number of ways. An independent review of the implementation of the Agreed Notes in March 1999 reported good progress in a number of these areas. These include macroeconomic management, aid co-ordination (implementation of SWAPs, PER/MTEF, Quarterly sector consultations, PRBS), and democracy and governance (multiparty system, formulation of Vision 2025, National Poverty Eradication Strategy, National Anti Corruption Strategy). According to this review, areas where there are outstanding problems include:

- There were still a number of separate or parallel donor systems/procedures on procurement, recruitment and staff remuneration, accounting, reporting formats, monitoring, and management of projects. All of them use significant amounts of the limited Government capacity
- There were still a large number of fragmented and uncoordinated project support which reduces efficiency and effectiveness
- Management and disbursements of resources outside the Government system (exchequer) was seen to be undermining transparency and accountability
- There was a heavy dependency on TA/consultants in executing projects which is very costly
- Country Assistance Strategies (CAS) were still reported to be uncoordinated

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<sup>1</sup> Sector Wide Approach Programme where programme objectives are shared and resources from donors are pooled in a basket fund

## **Move towards basket funding and budget support**

A significant change in donors' aid policies can be seen in many areas in Tanzania. Donors have moved into basket funding for a range of programs or processes. They include Public Expenditure Review, Local Government Reform Program, Agricultural Strategy, Rural Development Strategy, Road Program including TANROADS, Poverty Reduction Strategy Paper, Public Policy Reform Program, Legal sector, Health sector, Education sector, and Agricultural sector.

Many donors, including the World Bank have gone one step further and are now moving progressively from basket funding to budget support funding. World Bank is providing increasingly more support to budget support. EU has signed an agreement with Tanzania on budget support as the main aid programme and DFID is ahead of the rest of the bilateral donors in this type of funding, offering most of the total aid as budget support. Beside UK, the governments of Canada, Denmark, Ireland, Sweden, Netherlands, Norway and of Switzerland also support Poverty Reduction Budgetary Support (PRBS) which is combined with the World Bank PRSC credit.

The PRBS/PRSC programme exists alongside a number of other aid interventions in Tanzania and Norway is involved in many of them. Norway is involved in the PEDP<sup>2</sup> which is a sector wide approach programme (SWAP) and in a number of programme and project interventions. This spread out programme and project approach is also used by the majority of the donor organisations involved in Tanzania. Only DFID have made a conscious effort to move the bulk of its aid funding into the PRBS programme. The overall picture of development cooperation in Tanzania is therefore still fragmented and complicated.

The PRBS, in which Norway has been an active member since its inception, was designed as a continuation of the earlier multilateral Debt Fund (MDF) programme. The objective of the PRBS was to build on the HIPC and PRSP processes in support of the poverty programme and establish a useful dialogue with Tanzania on policy issues. The PRBS and its background is described in detail in a number of reports<sup>3</sup>. The PRBS/PRSC has been characterised as a well-functioning and a model arrangement that could be copied in other countries where aid volumes are significant in relation to overall public expenditure.

The Government of Tanzania (GoT) has stated very clearly that they prefer budget support funding to other aid modalities. In the Tanzania Assistance Strategy (TAS) in 2002 it is stated that the Government would like development partners to:

- As far as possible adopt the joint actions approach and harmonized rules and procedures (formulation, supervision and evaluation missions; accounting, disbursement and reporting; annual consultations, etc.) with the view to enhance government capacity.
- As far as possible untie aid and provide technical assistance for capacity building. Some donors have completely untied aid while others are still constrained by policy stance and legal framework
- Adopt the MTEF with the view to improve the predictability of resources.
- As far as possible donor support approaches which increase aid effectiveness.
- Decentralize authority on decision making to the country missions in order to expedite and deepen consultations

At the CG meeting in 2001, the President of Tanzania also stated:

*“While considerable progress has been made in preparing and costing sector specific interventions to alleviate poverty, the existing international financing mechanisms are, it*

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<sup>2</sup> The Primary Education Development Programme

<sup>3</sup> See for example: Tone Tinnes and Bertil Oden: 2003, “Tanzania: New aid modalities and donor harmonization” NORAD Report 8/2003 (October).

*seems to us, still largely similar to those of the preceding years. In our view, there is a pressing need to review these mechanisms, in order to ensure realistic, effective, and more flexible support for interventions aimed at reducing poverty. In this connection, the Government welcomes the increased willingness of the international partners to support our poverty reduction programmes on a “basket” and sector-wide basis, or through projects conforming to the poverty reduction strategy. More flexible and untied forms of international assistance are critical to our poverty reduction efforts at this stage, when it is becoming increasingly important to embark on more cost-effective and imaginative programmes for the benefit of the poor.”*

### **Aid still fragmented and unpredictable**

From GoT’s perspective, budget support have three main advantages over other forms of aid. First, Tanzania is extremely aid-dependent. Around 25-30 percent of the total Government budget and 80 percent of the development budget are dependent on foreign aid/finances. This means that predictability and flexibility becomes crucially important to get the overall budget process including resource allocation and macroeconomic management, to function.

Secondly, Tanzania has development co-operation programs with over 50 Governments/donors, international financial institutions and NGO covering hundreds of projects virtually in all sectors (TAS, 2002, p6). In this situation, fragmented and uncoordinated project aid reduces efficiency and effectiveness of assistance.

Thirdly, it has become apparent that the acclaimed changes in partnership and aid practice following the Helleiner report has not changed the perception of aid in Tanzania. Only a few people have been engaged in the changes in the Ministries and civil society. Indications are that the SWAPs in Tanzania has largely been regarded as strongly influenced by donors and the Bretton Woods institutions.

GoT officials are aware that relying on budget support can be risky for two reasons. The first is that in the case of an outbreak of some political or military incident that is against the human rights from the donors’ point of view, donors may withdraw all of their money from budget support because of fungibility problems as well as strong domestic political pressure. This has potential damaging effects on GoT’s overall development planning and implementation in the future.

### **Continued process overload**

Many government and development partners’ representatives in Tanzania now in 2004 point out that there is need for a renewed debate on aid modalities and the structure and content of the dialogue between government and development partners. It is acknowledged that there is a massive process overload in the interaction between government and development partners. It is reasonably clear that the overall capacity of government entities is influenced by this and that a number of normal government processes and functions suffer.

Policy making and implementation of policies are reviewed and debated by development partners. There are discussion forums for almost every policy area and open or implicit discussions of donor funding linked to it. The World Development Report 2004 estimates that Tanzanian government officials have to prepare 2 000 reports to donors and receive more than 1 000 delegations each year. This complicated dialogue pattern is based on several hundred bilateral agreements and many different aid modalities. The discussion of what level of detail donor agencies and embassies should expect to be involved in all the detailed political and social processes is important. In this discussion paper the main focus will be the relationship between aid modalities and the development of the Tanzanian budget process.

### **Need to strengthen the budget process**

Development partner representatives in Tanzania all point out that the overall political dialogue over the last decade has been successful. Tanzania has carried out a successful

economic reform programme. The country has seen significant results in economic growth, macroeconomic stabilisation, lowered interest rates and capital inflow. There has been considerable progress in a number of economic policy areas and in public financial management systems.

However, all involved parties also observe that there are important outstanding issues that need to be tackled. The main problem now could broadly be labelled the quality of the budget process. In the policy-budget-implementation chain which is at the core of the PRSP implementation and social development, the budget formulation is seen as the weak link. There is empirical knowledge about needs and social conditions and the overall planning process provides national policy objectives and plans, but the goals and objectives are not translated into properly costed budgets and overall priorities. The budget, therefore, does not function as the strategic policy and resource allocation tool it is supposed to be. A dysfunctional budget process is a problem in any country but even more so in a country with severe resource constraints such as Tanzania.

The problems of producing a good budget are not entirely technical. They are closely related to the structural under-funding of the budget, the cash rationing system and the perceived or real lack of knowledge or certainty about donor resources. Practise has shown that it is not feasible to invite the Tanzanian Parliament to vote on budget allocations that are the indirect results of donor driven projects and sector programmes. These resource flows are regarded as decided upon by development partners and therefore not included in the full budget process even though they might be listed in budget documents.

Many development partner representatives argue that the budget problem is mostly technical. There should be a possibility in carrying out an MTEF process, they argue, if only Tanzania had the technical capacity and political will. A good MTEF would mean that all resources are brought in to the resource envelope and that a bottom up or activity based budget process is carried out. Tanzanian government representatives on the other hand argue that it is not feasible when donor resources are fragmented, regulated by hundreds of agreements and basically rather unpredictable. Furthermore, the fragmented nature of the development assistance dialogue means that government officials are engaged in meetings and processes with development partners when they should have been working full time on budget planning.

The main conclusion is that the link between aid coordination, the choice of aid modalities and the development of the Tanzanian budget process is important. Analysis of this link is obviously not straight forward. It can (and should) be done by interviewing government officials on the priorities within their organisations and by carefully considering how the incentive structure and technical capabilities for line ministries and other spending units depend on their relationship with the donors.

Such an analysis will by all accounts show that a lot can be done by applying better methods to the existing funding structure, but that it is also fair to say that fragmented, uncoordinated and unpredictable aid hinders the development of a proper national budget process in Tanzania. Aid finances about 30 – 40 percent of activities in the public sector but only a small share of it is truly on budget and a part of the overall planning process. There is good reason to believe that if a large enough proportion of donor resources are truly on budget in the sense that they are known well in advance of the budget year, allocated through the political system and spent and accounted for through the treasury, then, two major positive effects will be achieved. The quality of the budgets will improve dramatically and the use of donor resources will be much better coordinated.

### **When are donor resources ‘on budget’?**

The term ‘on budget’ is often used un-critically by both government and donor representatives in many developing countries. It is of outmost importance to understand that being on budget is linked to the concept of ‘political contestability’ which means that resources for a given public sector activity is allocated in a budget process that creates a

contest with other activities. The contest process in most countries start in the preliminary budget discussions between ministry of finance and line ministries, moves on to cabinet level discussions and is finally settled in Parliament. It is reasonably undisputed that it is this contest which creates the main push for improved quality of the budget process in particular and in many cases for the political debate in general. Being fully 'on budget' therefore means that resources are:

- *On planning*, this entails that the resources are included in the resources envelope from the start of the planning process for the budget year in question. This would in most countries mean that resources are known with a reasonable degree of certainty at least 6 months prior to the start of the budget year.
- *In cabinet and parliament* which means that allocations and the reasoning for them are debated in cabinet before the proposal to parliament and then debated again. This is the main contest process. In fact, it can be argued that the apparent lack of political debate in many African countries about the enormous health and education sector challenges is caused by the fact that health and education sector budgets are never discussed among the political leaders in the country. The two line ministers are simply too busy sourcing funding for programmes and activities among donors to bother discussing with the minister of finance or the cabinet.
- *On treasury*, which means that public sector payment systems and banking system are being used and which ensures that there is an established pattern for the audit trail.
- *On accounts*, this means that normal country accounting system is being used.
- *On audit*, this means that the national audit office is responsible for carrying out audits.

### **The 'important' dialogue issues are mostly cross cutting**

When development partner representatives are asked what they would like to achieve in the dialogue with Tanzania, there is a remarkable unity in the replies. Everybody points to a number of cross cutting issues that are not sector specific as the main points of dialogue and everybody complains that it is difficult to get through on a number of these issues. This means that there is much to be gained from a coordinated dialogue. Sector specialists working as donor representatives also complain that their dialogue is too dominated by cross cutting issues and only very rarely really moves into the sector specific challenges.

In addition to the set of issue related to improved budget quality there are important ongoing reforms in the financial management area and in monitoring of social and economic developments and actual results of the poverty reduction programme. Topic for discussion includes poverty monitoring and analysis, improvement of economic statistics, tracking of social sector funding and actual service delivery in local communities. The main financial management reform element is the long awaited and planned public procurement reform, but there are also issues in the area of local government funding, roll-out of the IT-based accounting system etc.

The point here is that all these issues are recurrent in discussions with heads of missions, economists and sector specialists on the donor side and of both Ministry of Finance representatives and line ministries' representatives on the Government side. There is wide agreement that there is a need for a dialogue and technical cooperation on these issues and that this dialogue is cross-cutting and not sector related.

Obviously, the two sides differ somewhat in the analysis of what needs to be done. Donor representatives will typically say that there is lack of capacity and maybe political will and the government side will say that the dialogue with the donors is too complicated and demanding to get moving.

**General budget support as preferred modality**

The preferred model of development cooperation for Norway is for Government and development partners to work in partnership to implement the Government poverty reduction and development strategy, with donors providing predictable financing using Government systems where possible. Where there is agreement on policy and the allocation of public resources and where Government is able to execute and account for the aid, general budget support (GBS) through Government systems is seen as the preferred modality. Partner countries that are considered main cooperating partners such as Tanzania has been for a long time should normally be considered eligible for budget support.



### **3 Outline for a new Approach in Tanzania**

#### **Move more resources into budget support**

It is proposed that Norway moves the main part of its development assistance in Tanzania into the PRBS budget support. This would mean moving all sector support into the PRBS. This is based on the serious concerns of process overload in Tanzania and the important push needed to reinstate the Tanzanian budget as the main coordination and resource allocation tool in the public sector. It is also based upon the strong wish from Tanzania to increase the share of aid resources that is channelled through the PRBS mechanism and the fact that present Norwegian guidelines and checklists for budget support do not seem provide any clear reason why Tanzania should not be eligible for increased budget support, ref Appendix 2. This argument is further strengthened by the analysis that all important cross cutting dialogue issues of concern to the embassy are most effectively addressed in a budget support dialogue.

Equally or even more important is obviously what Norway manages to convince other donors to do in this regard. The report also contains a proposed rearrangement of the donor-government dialogue. Under the proposal the PRBS/PRSC meetings would be negotiation meetings where donors pledge support and where heads of missions meet. The present PRBS group would be replaced by the PER-Macro<sup>4</sup> group where government and donors would cooperate technically on the basis for the PRBS/PRSC process. All sector working groups should ideally be merged to form PRS sector advisory groups that would assist the line ministries in improving their planning and budget process and channel technical cooperation.

#### **Support the Budget as the coordination tool**

Donor coordination is a tool to reach the objective of reduced transaction costs and ultimately an indirect support to the improvement of the Tanzanian policy, planning and budget process. There is a tendency in the donor community to think that once procedures and processes of cooperation are harmonised and a good exchange of information and sharing of analytical work is established then all is well and good. There is a widespread failure to recognise the importance of the partner country's budget as the national tool to coordinate and prioritise policy and resources. The budget in Tanzania is in a sense not allowed to play the role we take for granted in other countries.

As is noted in the 2004 World Development Report, the problematic aspect of the donor – government relationship is not just that dialogue processes are not coordinated but that donors provide resources to the public sector that are outside the budget process. Different sectors represented by line ministries and other spending agencies in government access resources uncontested and outside the priority setting process. Government budgets and priority setting processes in most countries are based on contestability as the key driver for priority setting. Contestability drives research, policy development and ultimately political debate.

The important message in this for a country like Tanzania is that the combination of process overload and donor resources moving outside the total budget system hurts the budget process in two ways. Firstly, human resources are used to satisfy the donor dialogue in stead of the budget process and secondly, contest for resources is reduced.

Presented below is a sketch of how a budget focused framework could be set up. The main idea in the model is to de-link as much as possible of sector dialogue processes from the resource flows into the sector. Donor funding should move through PRBS/PRSC into the budget, through the contest for resources and into the sector spending units.

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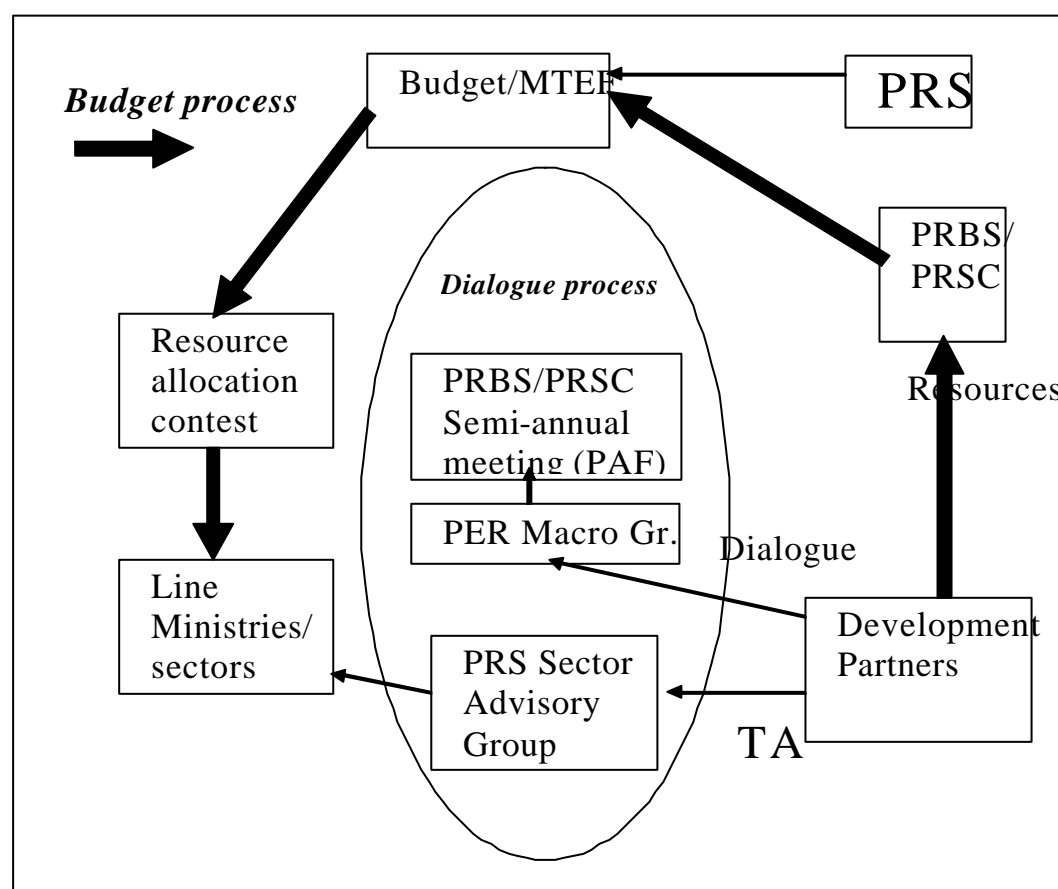
<sup>4</sup> Public Expenditure Review and Macroeconomic policy dialogue and cooperation group

The transfer of resources from donors uses the PRBS mechanism and only that. The idea is to get the donor resources included in the full budget contest process. This will stimulate the line ministries to produce better proposals linking sector information, goals, policies and budgetary inputs. In this mode, line ministries will be supported by the PRS Sector Advisory Boards, ref below.

### **Clearer definition of roles and responsibilities**

Many of the stakeholders in the government – donors' dialogue in Tanzania express that there is a need to define clearer roles for government and for donors in the many interactions they have. There are too many joint working groups and very often lack of clarity as to the status of reports and assessments that emerge for the groups. The intention has often been to improve cooperation and reach common goals etc. but the actual outcome can actually be less constructive overall.

To remedy this it is proposed to build on existing dialogue structures and define three different dialogue structures, the main PRBS/PRSC meeting which is a negotiation of the coming years programme, the PER-Macro which would be the technical working group to replace the PRBS-TWG<sup>5</sup> system. The new element is the preliminary named PRS Sector Advisory Groups. They are thought to continue the work of the PER sector working groups and also replace other sector working groups and basket funding groups. These groups should be offering top level sector policy advice and the donor representatives taking part here would be involved in their personal capacity as sector experts and serve as links to the donor community.



<sup>5</sup> TWG is a Technical Working Group under the overall PRBS umbrella

### **PRBS/PRSC meetings supported by PER-Macro technical group**

The main dialogue forum for the PRBS/PRSC support should, as today be semi-annual meetings in November and March. It is proposed to organise these meetings more towards overall dialogue issues on policy and achievements of the poverty programme. These meetings would be a negotiation process where roles are clearly defined and they should involve formal pledging of support from donors. The meetings should be based on the technical work of and discussions taking place in the PER-Macro group. The PER-Macro group would deal with all the poverty strategy, economic policy and financial management issues that are cross cutting.

### **And – by a new type of sector dialogue forums**

The new PRS Sector Advisory Groups would provide donors and government sector ministries with a forum for discussion on policy, budget proposals to be submitted to Ministry of Finance and technical cooperation. Donor representatives taking part in these groups would not pledge direct support but rather work with the government in an advisory capacity. They would also bring particular issues such as major policy reform, substantial deviation from plans and serious policy issues or slippages to the attention of the PRBS/PRSC meeting representatives in their own organisations.

### **Flexible approach to PAF issues**

It is of outmost importance not to overload the PRBS/PRSC dialogue process. The number of issues featured in the Performance Assessment Framework and discussed in the semi-annual meeting must be limited so as to get the right focus and depth. Sector issues such as education or health policy should be brought in on an as and when required basis.

### **Improved empirical base for the dialogue**

There is a recognised need in the donor community in Dar es Salaam to improve the level of knowledge and understanding of where the development process in Tanzania is heading. Organisations like NORAD used to have a high number of advisers all around Tanzania and where well informed about developments ‘on the ground’ in the country. Today the advisers are gone and donors are increasingly feeling uninformed about the social development process. There is a need to strengthen fact-finding and empirical work. Therefore bilateral donors like Norway should attempt to use more of its overall capacity in actual assessment work and what is often referred to as ‘reality’ checks.

This would both improve the assessment of whether aid is reaching the poor as is required from head office and the Norwegian Parliament but it could also mean that the embassy becomes a more competent dialogue partner.

Bilateral donors including Norway should also consider following DFID’s example of organising the work around teams in a matrix type organisation. The PRBS needs to become a key focus for more people in the embassy.

### **Phased and preferably coordinated move towards GBS**

The main candidates for phasing out would be the following:

- SWAPs, because they interfere directly with the budget process and move large resources outside the scope of contestability. SWAPs achieve little in terms of improved dialogue, they do not succeed in providing assurance of increased resource flows to priority sectors and they are seen as donor dominated and are generally cumbersome administratively.
- Area based support to districts outside the budget process. Tanzania is in the process of creating a formula based system for transfers to local governments. This is a very welcome development that should be strongly supported by donors. The area based programmes work outside the government system; they create unfair differences

between districts and are generally old fashioned in relation to OECD DAC recommendations on design of development programmes.

- Large project interventions that have a substantial element of recurrent financing or which entails recurrent financing to operate and maintain after the investment phase.

## **Appendix 1 Expected Outcomes of General Budget Support**

### **Features of a Budget Support Programme**

Many development economists discuss GBS as one of many possible aid modalities and one that should be used as and when and only if conditions are right. Others see the issue as much more fundamental and as something that represents a 'leap of faith' for the whole idea of development assistance. Theoretical discussions of the idea of budget support therefore tends to be either a checklist of when it is 'safe' from a political and fiduciary perspective to use budget support or a more fundamental discussion of how aid modalities actually influence policy-making processes, capacity and ownership of the development process in countries like Tanzania. The checklist approach is obviously useful but the other aspects which in a way represent the actual development impact are much more important from the Tanzanian point of view.

It is commonly recognised that GBS should be based on a policy environment which supports the implementation of the poverty reduction strategy. The donors should provide a predictable and stable flow of resources that enable governments to plan and manage efficiently public expenditure through the above mentioned 'contest' for resources. Donors should use partner government systems for monitoring and assessing progress towards PRS where they are of acceptable standards, and work to strengthen those that are not.

Assistance to government programmes should be through government systems and a fiduciary risk assessment should be undertaken to evaluate public financial management and accounting systems and ensure there is a credible programme to improve the standards of these systems. The decision to disburse funding through these systems requires a judgement that the potential development benefits justify the risk, taking account of any safeguards that can be put in place to buttress and develop these systems.

When things go wrong, it is envisaged that a range of measures can be taken depending on the seriousness of the problems. The general aim is to provide incentives for the partner Government to remedy the problems, though it is recognised the weight of research evidence that conditionality has not been very effective in persuading Governments to alter their behaviour. Possible responses can include enhanced policy dialogue, working with civil society and parliament to encourage responsible governance, and more traditional approaches to conditionality, creating a close linkage between implementation of defined actions and disbursement of resources.

Following OECD DAC definitions GBS cooperation consists of the following elements or inputs:

- Funds are paid into the national budget and through the treasury system of the partner country. Resources become intermingled with domestic revenue and can be used directly in the budget.
- There is a structured policy dialogue linked to the budget funds and an implicit associated process of conditionality. This policy dialogue is usually closely linked to the poverty reduction strategy of the partner country.
- There is a link to improved capacity by technical assistance in particular in areas associated with public financial management and economic and social policy formulation.
- GBS represents a unified approach but each donor might have additional conditions and dialogue points over and above the main common issues.

### **Expected immediate or direct effects of budget support**

The main expected immediate effects<sup>6</sup> of GBS would be a change in the relationship between aid, the national budget and national policy processes. Obviously, these effects will vary in strength depending on the size of the GBS support relative to the overall support and by actions by government or non-GBS donors. It does seem likely that the effects caused by an increased share of GBS are not linear but that they ‘kick in’ at a certain level or threshold. In a country like Tanzania this would probably be when the substantial social sector support programmes within health and education.

- It is to be expected that an increased proportion of external funding is made subject to national budget processes or fully ‘on-budget’, ref discussion above. Practical experience in Africa has shown that GBS is the only form of aid that actually satisfies all of these criteria.
- The form of policy dialogue between government and development partners changes, so as to focus more on national public policy and public expenditure issues and processes.
- Technical assistance and capacity-building efforts are increasingly being re-oriented so as to focus on mainstream activities of Government (public policy and public expenditure issues rather than project management and administration).
- External assistance is more aligned with national goals and systems.
- Donor activities in the country are more harmonised.

### **Indirect and longer term effects**

The institutional or longer term effects of increased share of GBS will result from the changed incentives throughout government that is generated by the increased importance of the national budget. The quality of budget work increases as the demands of the contest increases. From a theoretical point of view this would manifest itself in several ways:

- The improved predictability of budget funding would reduce the cost of budget financing and make it more uniform across different expenditures. This affects the resource allocation process, the liquidity management and the cost of borrowing.
- The partner government would gain more control over public sector programmes through the budget and make it easier to bring them into line with government goals and service delivery targets. It would be easier to align PRSP processes with government systems and cycles and to promote harmonisation by donors.
- The increased contest between different expenditure categories would lead to a more effective budget process and reductions in transaction costs associated with development assistance.
- Official reporting lines and budget procedures would be more respected and public service performance incentives would be strengthened. The ‘brain-drain’ effects of parallel project management structures would be reduced.
- Last but not least structures and processes of democratic accountability would be strengthened. This would include a greater role for parliaments in monitoring budget results, greater scrutiny by domestic institutions over donor-financed spending and a general improvement in transparency and the conditions for democratic accountability.

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<sup>6</sup> The discussion here is based on the background material for the OECD DAC GBS evaluation review exercise which will cover 8 countries and run for the next three years. Tanzania is not included among the eight.

## **Outcomes and impacts**

The outcomes and impacts from a switch to GBS from a theoretical point of view relate to two factors. Firstly, government would have a significantly improved capacity to influence the determinants of poverty in a positive way. These determinants include economic growth, inflation, market regulations, tax systems and public service delivery. Secondly, the government system would have to become more accountable to Parliament and wider society and therefore more politically inclined to implement poverty reducing policies. The lesson from most countries' budget processes are that if a cabinet of government ministers is forced to discuss health budgets, they will also discuss health policy and health status and how to win votes by improving health outcomes.

Thus, in the medium to long term, one would expect to see the following outcomes:

- The creation of a stable macroeconomic environment, conducive to private investment and economic growth.
- An improvement in the quality of services delivered to the public, particularly in the delivery of pro-poor services and in the targeting of those services to the poor.
- Effective assumption by government of its role as a regulator of private initiative.
- Provision of a framework ensuring justice, law and order and respect for human rights
- Appropriate public actions to address market failures, including those arising out of gender inequalities.

## **Earmarking of budget support**

Earmarking is a way of tying budget support to the financing of pre-specified items within the National Budget. Depending on whether the control over the external resources is ex post or ex ante, a distinction can be drawn between 'virtual' (or notional) and 'real' earmarking.

### **Virtual/notional earmarking**

Where the control over the use of DBS resources is exerted ex post, the term 'virtual earmarking', or 'notional earmarking', is commonly used. In this system, DBS resources are made available to the budget according to a fixed disbursement schedule, with the use of these resources then being 'justified' against pre-agreed budget lines. This requires national authorities to ensure that spending against these lines is equal to or greater than the disbursed DBS tranches, but it permits resources to be managed through the normal banking and financing systems of government. So long as the reporting periods are quarterly or longer and the chosen budget lines are ones which would in any case have been financed, the DBS resources remain fungible and the costs imposed are purely administrative.

### **Real earmarking**

Where spending on agreed budget lines needs to precede the release of DBS tranches, the earmarking process is real. Special bank accounts need to be created to hold the DBS resources until expenditures are confirmed and this means that resources are not fully fungible in the short term. In so far as resources are directed to budget lines which would have been financed anyway, DBS resources will serve to liberate domestic resources, i.e. they will be fungible. Under these circumstances, beyond the short term, the main cost is again administrative.

## **Appendix 2 Practical Implementation – the Checklist Approach**

Donors are increasingly using checklists to develop a standardised basis for an assessment of when GBS can and should be used. In terms of practical implementation it could be argued that this checklist does not always appear to be the same in different countries. The reason for this is that there is always an element of discretion or political assessment. There is an element of chicken and egg problem in the checklist approach.

The underlying assumption regarding GBS is that the dialogue is much more effective than other forms of aid and therefore provides a much better chance of reaching goals in, for example, the area of financial management. The checklist approach; however is to check whether financial management systems are 'good enough'. This duality shown in the case of budget support to Mozambique which has been ongoing for a number of years, and Zambia which has not started yet because of too little progress in the area of financial management. It could be argued, however, that the systems of accounting and auditing in Mozambique are less satisfactory than in Zambia.

Checklists typically deal with issues within three main areas, i) the PRSP and its policies and priorities, ii) macroeconomic policy, iii) budget process and the financial management systems' ability to implement policies and resource transfers. Below are some brief comments on the situation in Tanzania.

### **1 Is there agreement on policies and priorities?**

The PRBS/PRSC progress report from January 2004 notes that in recognition of the enormous challenge in combating poverty the Government of Tanzania has stated a clear intention to refocus priorities towards social sectors and primary services within them. Long-term targets for poverty reduction were articulated in the Vision 2025 and the Poverty Reduction Strategy (PRS) provides a medium term strategy for poverty reduction. The PRS details the characteristics of poverty and monitorable benchmarks. The TAS, which was published in June 2002, provides a broad strategic national framework for managing external resources to achieve Tanzania's development objectives.

The TAS and the PRS focus on how to combat poverty in an effective manner, both in terms of more effective use of public resources and in improving the possibilities for economic growth, employment creation and income generation. The TAS and the PRS identify priority sectors while the MTEF/PER process is the mechanism for prioritising poverty reduction in the government budget, such that resource mobilization and allocation reflects these priorities.

The Government of Tanzania has prepared two Poverty Reduction Strategy Progress Reports and the third is soon to be released. The report will outline the progress made in implementing Tanzania's poverty reduction strategy during fiscal year 2002/03 (July-June), and also update the Poverty Reduction Strategy Paper (PRSP) of October 2000.

In the area of indicators and analysis, the government has completed comprehensive analytical work on poverty, and developed a more complete set of indicators. Progress against the targets set out in the PRSP has been generally good, with the growth and educational targets surpassed, but slower-than-hoped for progress on health indicators.

The PRSP process in Tanzania continues to be an open and transparent one. The Progress Report is benefiting from the deliberations of a Poverty Policy week held in September 2003. This effort involved a wide range of stakeholders.

The Household Budget Survey and other data sources, as well as specialized studies of vulnerability, urban poverty, and the geographic distribution of poverty has been presented in a comprehensive Poverty and Human Development Report (PHDR).



In conclusion there is a good agreement on goals and policies between Tanzania and development partners.

## **2 Are economic policies conducive to economic growth?**

The last PRBS/PRSC review notes that since the mid-1990s, Tanzania has made substantial progress in macroeconomic stabilization and structural reforms in the economy. In the beginning of the reform process, economic growth was slow to pick up but over the last 5 years or so it has averaged more than 5 percent. The positive development continued into 2002 when real GDP grew by about 6,2 percent.

Inflation has kept below 5 percent. Fiscal consolidation has been central to the success in macroeconomic stabilization. In support of Tanzania's reform program, donors have provided sizable financial assistance and this has almost eliminated the government's domestic financing needs. This has again led to lower interest rates and stimulated private sector growth.

The report goes on to note that the main concern in the medium term is the continued low revenue yield, which is a major challenge for Tanzania. The projected medium-term revenue targets are achievable, with implementation of a comprehensive strategy for reform of tax administration and policy.

Monetary developments in recent years have been characterized by strong liquidity effects of foreign inflows that were not fully sterilized. There has been a marked improvement in the functioning of the financial system but relatively slow growth in bank lending. Also notable is the fact that the spread between deposit and lending rates have narrowed. This reflects the growing competition in the banking sector.

Tanzania's overall balance of payments position improved in 2002/2003 because of larger inflows of donor assistance, as well as the impact of debt relief under the HIPC Initiative. However, the current account deficit, excluding official transfers, widened slightly. There was a strong increase in non-traditional exports, mainly gold, combined with a moderate improvement in traditional exports, reversing a declining trend. The government has made further progress in implementing reforms in the public enterprise sector.

In conclusion the main concern in this area is tax revenue performance but the rest of economic policies are given very good marks. Tax revenue has by some economists been called the 'Achilles heel' of GBS. GBS offers a politically easy substitute for domestic revenue. On the other hand, so does all development assistance and GBS at least offer a good basis for dialogue on the issue.

## **3 Can the budget process plan, execute and account for public spending?**

The PRBS/PRSC report notes that GBS in Tanzania should evolve according to and in co-ordination with the development of the budget process and continued strengthening of public sector management. It is further noted that this GBS offers the only real opportunity of fully integrating development assistance into the planning and budgeting process. Increasing the share of development assistance in this form further will, however also hinge upon the initiatives the government is taking to improve and strengthen the budget process. This would include more strategic focus on the overall budget allocation and linking the budget process clearer to outputs and outcomes.

The joint review of budget execution for 2002/03 and the approved budget for 2003/04 concluded the following:

- Accumulation of expenditures (other charges) towards the end of the fiscal year suggests problems with planning at sector level and continued problems with procurement.
- There have been absolute rises in priority sector expenditure since 1999/00 to 2003/04 in line with rising budget support.

- There is a slight decline in the relative share of priority sector expenditure to total expenditure between 2001/02 and 2002/03 and between 2002/03 and 2003/04.
- Estimation and capturing of project funds arose as issues of concern.
- Recording of broken down information of the actual recurrent and development expenditure elements of basket funds is difficult.
- The Government observed the PRGF fiscal target on net domestic financing. The net position was a build up of Government deposits amounting Tsh 36.3 billion.

Donors and government agree that procurement problems need to be addressed. The Government has identified proposed amendments to the Procurement Act of 2001. Intensive training has been initiated at MDAs and at the Central Tender Board. Other improvements to the central procurement process include proposals to change the Central Tender Board to a Public Procurement Regulatory Authority, which are expected to be tabled at Cabinet in February 2004. The Authority is expected to be established in July 2004. This is expected to allow more flexibility in procurement for spending agencies and hence to facilitate expenditure in line with sectoral strategies.

There has been a rise in allocations to regions and local governments in the priority sectors by 37 percent in 2003/04. The policy strategy is to fund priority programmes, and to devolve expenditure as much as possible from MDAs and sector programmes to local government authority and district-based programmes. This shift in allocations is progressing.

The PRBS/PRSC review notes that the government has taken a number of positive steps in the past year to address the issue of revenue losses through tax exemptions. Further on tax administration, a new 5 year corporate plan for the Tanzania Revenue Authority (TRA) has been developed. The new corporate plan incorporates the main recommendations from several studies carried out in 2002 (including by the IMF/Fiscal Affairs Department), and development partners in the Tax Administration Project.

Tanzania's financial management system has undergone a number of reforms and improvements in recent years. It is one of the few functioning computerised accounting systems (IFMS) in the region. PRBS/PRSC report is concerned however about progress in implementation of the Public Financial Management Reform Programme. Key clarifications required to move towards implementation are under discussion. It is also noted, however that there are a number of other actions in the PAF that have satisfactory progress. This includes among other issues the roll out of IFMS to local governments.

The PRBS/PRSC report expresses that in the area of anti-corruption work there has been significant improvement in MDAs' reporting with some gaps in the various reports. However, it is pointed out that there is need for institutionalisation of donor-GoT dialogue on anti-corruption issues. In conclusion, the quality of the budget process and some cross cutting financial management issues causes concern in Tanzania. It is worth noting that progress is being recorded in these areas as well and that, again, GBS most likely offers the best dialogue basis for these issues.

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