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Research Paper No. 2005/58

Innovative Ways of Making Aid Effective in Ghana

Tied Aid versus Direct Budgetary Support

Peter Quartey*

September 2005

Abstract

There has been significant amount of aid inflows to developing countries including Ghana, but these have been very volatile. Aid flows have been associated with low domestic resource mobilization and have reduced Ghana to a country heavily dependent on aid. The amount of official development assistance (ODA) inflows has fallen in recent years and has become unpredictable. It is general knowledge that aid has not yielded the desired benefit. In an attempt to improve aid effectiveness donors have used tied aid not just to promote commercial interests but also to target aid to particular projects that have direct links with poverty. However, this has not yielded the maximum benefits required. Recently, the government of Ghana and its development partners agreed on an aid package dubbed the *multi-donor budgetary support* (MDBS), which would ensure continuous flow of aid to finance the government's poverty related expenditures.

This paper examines the MDBS, with special focus on how it overcomes the problems of tied aid and other project support. It concludes that the MDBS is innovative and could work in Ghana, but it would need trust and a well-designed, coordinated effort on the part of the government of Ghana and its development partners. Second, its effectiveness would depend .../.

Keywords: multi-donor budgetary support, tied aid, poverty reduction

JEL classification: F21, F34, F35

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crucially on measures to help reduce the debt burden, so that the government would not be compelled to use aid inflows to service its debt. Finally, the MDBS could be more effective if it did not have to operate alongside other project support.

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Acronyms

CDF	comprehensive development framework	CG	Consultative Group
DfID	Department for International Development	DPs	development partners
ERP	economic recovery programme	FM	Framework Memorandum
GDP	gross domestic product	GNI	gross national income
GoG	government of Ghana	GPRS	Ghana Poverty Reduction Strategy
HIPCs	heavily indebted poor countries	IFIs	international financial institutes
IMF	International Monetary Fund	MDBS	multi-donor budgetary support
MTEF	medium-term expenditure	NLC	National Liberation Council
NPP	New Patriotic Party	NRC	National Redemption Council
(P)NDC	Provisional National Defence Council Congress	ODA	official development aid
OECD	Organization for Economic Co-operation and Development	PRSP	poverty reduction strategy paper
SAC	structural adjustment credit	WB	World Bank

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1 Introduction

Developing countries, including Ghana, have been burdened with severe resource problems. A number of these countries are aid-dependent (Table 1) and their fiscal and current account deficits are unsustainable in the face of severe debt problems. The debt stock is extremely high and the proportion of government revenue spent on debt servicing places a severe burden on many developing countries, Ghana included.¹ In certain countries, debt servicing exceeds government expenditure on education (see, for instance, Osei and Quartey 2001). In an attempt to rescue the situation, donors have often used tied aid² not just for self commercial interests but sometimes to facilitate aid effectiveness,³ but without the hoped-for results. In view of the resource constraint in many developing countries and the fall in ODA flows to these countries (Bulir and Lane 2002; Alesina and Dollar 2000), donors are faced with two complementary options: (i) develop new or innovative sources of financing for developing countries, and (ii) find new ways of making aid more effective.

The Department for International Development (DFID) and a few other donors have considered the latter option. The donor community and the government of Ghana have agreed on an aid package dubbed the *multi-donor budgetary support* (MDBS), which is aimed at ensuring a continuous flow of aid to enable the government to finance its poverty related expenditures. The aid is to be paid into a fund and the government has the prerogative to determine the priority areas on which the funds are to be spent, a distinct advantage over previous arrangements where a part of aid is tied. Moreover, an important conditionality is that the money is spent judiciously and donors must be satisfied that the government is pursuing the right policies before funds are released.

Laudable as this idea may seem, it raises a number of issues, which need to be examined. Given that donors may consult each other, would this affect the amount of aid inflows because bigger donors may be tempted to cut back on the amount made

Table 1
Aid dependency—Ghana

	1996	2001	2002
Net ODA or official aid, US\$	651 million	652.9 million	652.8 million
Aid per capita, US\$	37	32.8	32.2
Aid as a % of GNI	9.6	12.6	10.8
Aid as a % of gross capital formation	32.2	46.2	53.8
Aid as a % imports of goods & services	25.5	17.7	18.6
Net ODA as a % of government expenditure	–	34.5	–
Debt service as a % of exports	17.4	8.4	6.6

Source: World Bank (2004), IMF (2002).

¹ In Ghana, debt service as a percentage of exports was 17.4 per cent in 1996, 15.1 per cent in 2000 but thanks to HIPC, the debt service ratio reduced to 6.6 per cent in 2002 (World Bank 2004, also see table 1).

² Tied aid is defined in this study as project aid contracted by source to private firms in the donor country. It refers to aid tied to goods and services supplied exclusively by donor country businesses or agencies. Aid can also be tied to conditions such as policy or institutional reforms but the paper narrowly defines tied aid to exclude aid tied to conditions.

³ Defined in terms of aid's contribution to poverty alleviation or sustained poverty reduction.

available to Ghana? Second, would donors restructure their aid and possibly reduce the grant component? Another worrying issue is that not all donors have signed up to support the agreement, as in the case of Japan, one of Ghana's biggest donors after the World Bank (WB). This raises the assumption that Japan's assistance would continue to be in the form of food aid and project support, often with high transaction costs.

Furthermore, the multi-donor budget support would operate alongside other forms of project aid, raising the issue of the mix of aid. Would the mix between MDBS and the other forms of project aid necessarily make aid more effective? This paper examines these issues in the light of the current dimension of aid flows to Ghana. Section 2 outlines the pattern of aid flows to Ghana since its independence and examines aid's probable impacts on the economy. The next section considers how to make aid more effective, and outlines the MDBS system and its operational framework, and examines its likely gains. The section also discusses some of the issues raised here. The final section concludes.

2 Profile of aid flows to Ghana

Ghana currently receives aid in various forms, including general budgetary support, sector budget support (mainly health and education), and project aid using parallel systems. Until the mid 1960s, aid flows were relatively unimportant in Ghana (Harrigan and Younger 2000) because the Nkrumah government was highly suspicious of the major donors, i.e., Britain and the USA, which did not help the already poor state of affairs. But more particularly, the economy, as it emerged from colonial rule (Killick 1978; Brownbridge 1994; Quartey 2002) had inherited substantial foreign exchange reserves, little debt, and a small public sector. Very little foreign exchange and budgetary support were needed until the 1961 balance-of-payments crisis (Killick 1978; Harrigan and Younger 2000; Quartey 2002). Although there was an interest in attracting aid after 1961, Nkrumah's criticism of Britain and the USA, the two major western donors⁴ made them less attractive sources of assistance. Eventually, Nkrumah did succeed in attracting support from the eastern bloc but the relationship deteriorated early in the programme and this severely limited disbursement (Killick 1978).

In the mid 1960s, the situation began to improve and aid inflows as a share of GDP increased from 0.002 per cent in 1960 to 0.22 per cent in 1965 because the new National Liberation Council (NLC) government, which ousted the Nkrumah administration, was more favourable to foreign interests (Quartey 2002). NLC agreed to reschedule the debts accumulated by the previous government. It sought assistance from the IMF in response to the balance-of-payments crisis in 1965/66, devalued the currency and pursued a prudent fiscal budget. Although these measures attracted increased assistance, most of the inflows were used to settle commercial debts contracted by the previous government (Harrigan and Younger 2000; Quartey 2002).

The economic policies of the 1970s were not impressive either and aid inflows declined during the first half of the 1970s, but the second half recorded more than a compensating increase. ODA as a share of GDP increased from 0.013 per cent in 1974 to 0.023 in 1978. According to Harrigan and Younger (2000), there were three reasons for this increase. First, the East and Western allies of the developed world were

⁴ Except the Volta River Project, this was partly financed by the World Bank, Britain and the USA.

competing for Africa's loyalty in the post-independence period when most African states began to distance themselves from their colonial powers. Second, most donors realized the severity of poverty in Africa relative to other developing countries and responded with more foreign assistance. Finally, the development community shifted away from the emphasis of growth being the engine for poverty reduction towards a more direct intervention to satisfy basic human needs. This shift weakened the link between aid flows and good economic policies.

In 1972, the government of the National Redemption Council (NRC), which took over from the NLC government, repudiated 35 million pounds of Nkrumah's debt and this brought a sharp response from commercial donors in 1973 and 1974 (Brownbridge 1994; Quartey 2002). However, in 1975 Ghana agreed to reschedule 100 million pounds of its external debts and this triggered the country's inclusion in the global flow of aid to Africa. However, this did not improve the country's payments position significantly but rather increased the country external debt since most of the aid was in the form of multilateral loans instead of grants. Ghana's foreign debt increased substantially from US\$895 million in 1975 to US\$1407 million in 1980 (Harrigan and Younger 2000). To make matters worse, the source of Ghana's external financing contracted to a small number of donors, with the World Bank being the major donor.

The early part of the 1980s witnessed a gradual reduction in aid flows to developing countries and Ghana was no exception. The nationalism of the Rawlings administration compounded the poor state of affairs. The economic decline at the time caused donors to lose hope in Ghana, but soon potential donors were eager to influence the country's policymakers for a radical shake-up of its economic policies. The Rawlings government shelved its socialist ideologies, suspended the 1981 and 1982 annual budgets and instead fashioned out an economic recovery programme (ERP) in 1983, which got the approval of the two Washington-based institutions. Both institutions pledged their support and reconvened the defunct WB and IMF consultative group of aid donors. Pursuing the economic recovery programme in spite of the hardships made Ghana the pet of donors.

Aid flows had increased substantially by the end of the 1980s and Ghana was receiving more foreign aid per capita than the average for Africa and other developing countries. The added inflows coincided with increases in growth but it is not clear whether the increase means causation. It can be argued that the increased inflow had a positive impact on growth at least during the early part of the ERP (Aryeetey and Cox 1997). Policy conditionality of programme aid flows ensured that neither fungibility nor Dutch disease plagued aid inflows (Younger 1992). Harrigan and Younger (2000) argue that public spending in Ghana had fallen to extremely low levels and capital spending had almost disappeared, which enabled the government to reduce its investment spending to finance public consumption in response to aid inflows. Also, the inflow of aid bridged the gaps in foreign exchange and capital availability, thus providing support for reconstruction of basic infrastructure, and the imports of spare parts and capital equipment

The late 1980s and early 1990s marked a new phase in Ghana's economic situation. During the period, the government took advantage of the high return public investments; infrastructure rehabilitation and markets were functioning at a level comparable to the pre-ERP period (Harrigan and Younger 2000). The foreign exchange market was liberalized during the reform period which meant that subsequent inflows

induced a foreign exchange appreciation, thus dampening the incentive to export. Second, the government's attempt to neutralize the monetary effects of the inflows severely limited credit to the private sector (Younger 1992). Eventually the continued inflows led to the Dutch disease situation: exports and private investment were crowded-out by tight monetary policy.

After the 1996 elections, one constitutional requisition was the drawing up of a development plan. A medium-term development framework called *Vision 2020* was prepared for the period 1997-2000 to provide a plan for the poverty reduction strategies of the country. Similarly, after the 2000 presidential and parliamentary elections, the Provisional National Defence Council Congress ((P)NDC), after being in power for over 20 years, lost to the New Patriotic Party (NPP) under the leadership of President Kufour. The policies and programmes pursued in the NPP's development plan (Ghana Poverty Reduction Strategy, GPRS) were not different from those of its predecessor.

2 Aid strategies of major donors

Over the years, aid flows to Ghana have taken different shapes and forms. In the 1960s and 1970s, as aid expanded, donors also began to diversify their aid portfolios. More emphasis was placed on infrastructure development, the productive sectors, particularly agriculture, health and education as well as poverty alleviation. However during the 1980s, there was a shift towards policy-based programme lending as opposed to traditional project lending, with the WB as the principal donor (Baffour 1999). This shift was accompanied by donor conditionality, mainly macroeconomic reforms and economic growth, which were implemented through stabilization and structural adjustment reforms. The main economic strategy was the economic recovery programme, which was to cover three phases, namely, stabilization, rehabilitation and liberalization. Thus, donor policy conditionality as well as donor-funded projects during the major part of the 1980s were focused on rehabilitating the deplorable state of the country's social and economic infrastructure. From the mid-1980s onward, donor policy also included the reform of civil service, privatization as well as the creation of an enabling environment for the private sector (Quartey 2002).

Unfortunately, the first phase of the ERP did very little to alleviate poverty and this sparked off concern over the social dimensions of adjustment. A second structural adjustment credit (SAC) was signed in 1989 to address the long-term issues of poverty, rapid population growth and food security (Harrigan and Younger 2000). Hence, the government and the World Bank established in the 1990s a common agenda to alleviate poverty. This policy became operational in 1993 when the WB proposed its own poverty reduction approach with enhanced investment in human capital, a better framework for private sector participation, and specific targeting of policies to areas where the poor operate, especially the agricultural sector. Another major shift in aid policy in the 1990s affected the sector-level strategies. The role of the private sector in economic development was not given priority in the ERP. The WB and its allies recognized that private-sector constraints had been overlooked. These had prevented the sector from responding positively to the ERP, particularly in terms of bringing structural change to the economy and diversifying exports. More support began to flow to the private sector, particularly agriculture.

In the early part of 1999, the World Bank launched the comprehensive development framework (CDF) as an initiative to promote greater coordination in development assistance within aid-receiving countries (World Bank 2003). The aim of the CDF was to bring all partners of the country together to deliberate with the government on how to support its development agenda or programmes. In other words, the objective was to bring external partners together to finance the country's development programmes rather than conduct numerous individual projects, most of which have no country ownership. Ghana was selected as one of the twelve countries to participate in the pilot stage. This has deepened coordination among the country's development partners, and has facilitated country ownership, as is exemplified by the transfer of the Consultative Group (CG) meeting venue from Paris to Accra. It must be emphasized here that ownership is different from authorship of development policies of programmes but what matters most is the government's commitment to ensure proper implementation (see Morrissey and Verschoor 2003). In Ghana, although authorship does not solely rest with the government, the level of commitment has been very high.

The CG meetings has led to the creation of a mini-CG, which provides a regular framework for the government to formally meet its development partners on a quarterly basis under the co-chairmanship of the minister of finance and the World Bank's country director. As a result, the World Bank has decentralized its operations in Ghana, so that it now has a country director, which has helped to speed up processing. Most procurement decisions (up to US\$10 million for goods and US\$5 million for services) are now made in Accra (World Bank 2003), and this, with a few exceptions, accounts for almost all decisions annually.

Emphasis has still been placed on country ownership and good policies, factors which should make aid effective. Donors, particularly after the 2000 elections, began to be concerned about making aid more effective and therefore the need for innovative ways of improving the effectiveness of aid. After considerable deliberation, donors agreed on an aid policy known as the multi-donor budgetary support (MDBS), which is believed to lead to pro-poor policies and facilitate aid effectiveness. The MDBS is discussed later.

3 Improving aid effectiveness in Ghana: tied aid or direct budgetary support

In many developing countries, foreign aid serves as an important source of revenue. In a WB study on the fifty most aid-dependent countries, it was observed that the mean value of aid as a share of central government expenditure for the period 1975-95 was 53.8 per cent (van de Walle 1998). This raises the question of whether this huge amount of money has been applied effectively? In other words, have these inflows resulted in significant poverty alleviation in the recipient countries? If not, we need to consider how to make aid more effective? Should aid be tied to specific projects or conditionality, or should governments be allowed to determine how aid can be effectively utilized within their countries without influence from donors' commercial self-interests?

Tying aid to a specific source in the donor country does not benefit the poor in the recipient country, and is seen as a way of pursuing the commercial self-interests of the donor (Svensson 2000). Consequently, the focus has shifted to direct budgetary support.

The contemporary rationale is to use aid funds to support pro-poor policy, particularly for pro-poor expenditure patterns. The aim of this policy is not to drive government reforms but rather to support government policy and reforms. It is worth mentioning that supporting a partner government's budget alongside IFIs loans is not a new concept for bilateral donors. What has changed over time is, instead, the rationale for doing so and the focus of the dialogue and monitoring.

The central question is, what should the new aid policy be? Should aid policy focus on tied aid, or on some combination of tied and untied aid, or should the emphasis now be on direct budgetary support which ties aid to good domestic policies aimed at poverty alleviation in aid-dependent countries? Next we examine two forms of aid, i.e., tied aid versus direct budgetary support.

3.1 Tied aid

Tied aid is defined as project aid contracted by source to private firms in the donor country (Svensson 2000). Tying aid to goods and services supplied exclusively by donor country businesses or agencies severely reduces its impact on development. Tied aid increases the cost of assistance and has the tendency to make donors focus on their commercial self-advancement rather than what developing countries need. Aid can be designed in many ways to pursue the commercial objectives of donors; one pervasive means is the insistence on donor country products.

Others have argued that tying aid to donor-country products is common sense; it is a strategic use of aid to promote the donor country's business or exports. It is further argued that tied aid, if well designed and effectively managed, would not necessarily compromise the quality or the effectiveness of aid (Aryeetey 1995; Sowa and White 1997). This argument, however, is valid to programme aid in particular, which ties aid to a specific project or policy, and where there is little or no commercial interest. But it must be emphasized that commercial interests and aid effectiveness are two different things and it would be difficult to pursue commercial interest without compromising aid effectiveness. Development maximization should be separated from the notion of pursuing commercial interests. Tied aid improves donors' export performance, and creates jobs and business for local companies. It also helps to integrate firms lacking international experience into the global market.

On the contrary, aid recipients would agree that tied aid is costly; it distorts agreed priorities, burdens governments with ever-increasing recurrenting local costs and invites corruption (Baffour 1999). Baffour (1999) further argues that for Ghana the estimated price differentials between aid imports and non-aid imports translate into a total cost of at least US\$350 million, that is, an average cost of at least US\$40 million per year during the 1990-97 period. It is important to qualify this estimated cost. Since aid imports include grant-financed imports, it is to be expected that actual costs could be reduced. Nevertheless, the significance of the estimated costs should be seen in context. Over the 1990-97 period, aid imports to Ghana averaged about US\$80 million per annum. Thus, the estimated annual cost of aid tying of about US\$40 million is nearly half the annual average cost of aid imports to Ghana. In other words, the level of aid imports could have been one-and-a-half times the magnitude actually received if aid-import prices had reflected those of non-aid imports. It is apparent that the price differentials imply a significant loss of essential imports to Ghana.

Aryeetey, Baffour and Quartey (2003) support this finding in their microeconomic study on tied aid in Ghana. They note that aid-funded projects to this country would have been more beneficial for the communities and would have had greater impact if donor conditionality had not been attached, particularly in the procurement process which showed that 75 per cent of the projects examined were not competitively processed. Such an undeserved 'monopoly' leads to higher prices and reduces the impact of tied aid projects. Consequently, a significant amount of resources is lost through aid tying. Moreover, tied-aid projects do not strengthen local capacity because service contracts are usually single-sourced and do not involve local contractors.

An important area of tied aid has been technical assistance, which often accounts for a sizeable proportion of the inflows. This traditional assistance in certain cases yields no meaningful results; resident expatriate staffs have tried in vain to superimpose institutions and concepts on existing social and political norms and values. The practice of sending expatriates to aid-receiving countries has undermined institutional capacity locally (Aryeetey, Baffour and Quartey 2003), perpetuated aid dependency and prevented developing countries from taking charge of their own destiny (Svensson 2000). The focus should now be on true demand-driven forms of expatriate support, not to create employment in the donor country.

Others have argued that aid tied to conditions is a better alternative than aid tied to a project which is often associated with the objective of commercial gain for the provider. Aid tied to good domestic policies (conditions or reforms) may positively affect economic growth through its influence on economic policy. Studies of Ghana have shown that aid makes good policy possible, and good policy promotes economic growth (Aryeetey 1995; Sowa and White 1997). Similarly, Burnside and Dollar (1997, 2000) conclude from their empirical work that aid does flow to countries with good macroeconomic policies and that aid has a positive effect on growth in these countries. However, this argument runs counter to the traditional growth theory, i.e., the economy is efficient and policy is non-distortionary, but the argument may hold in the African context where certain governments have not pursued growth enhancing policies (Harrigan and Younger 2000). This introduces a conundrum: which promotes growth—aid or policy? I would say both—foreign aid works in a good policy environment.

However, the existence of isolated projects has not made aid very effective even in countries with good domestic policies. Isolated projects have not resulted in any significant or sustained reduction in poverty, particularly at the national level. Furthermore, isolated projects do not always have the perceived benefits of channelling developmental resources through local systems. The shift in focus towards direct budgetary support has occurred for specific reasons, including the perceived failure of 'money only' instruments to drive significant domestic reforms. Also the MDDBS was proposed because project support as the vehicle for achieving sustained reduction in poverty levels has failed.

Recently, tied aid has not been well received by aid recipients or within the international community. Twenty-two developed countries reached an agreement in May 2003 to eliminate tied aid for certain categories of development assistance to the world's poorest countries. Introduced by an OECD committee, the agreement compelled a participating donor to offer aid to a beneficiary country without obligations of utilizing the funds for suppliers from the donor country. The agreement recommended that aid, loans and grants—covering a wide range of financial and project support such as capital

equipment, sector assistance and import support—should be open to international competitive bidding.

In a nutshell, tied aid has been the less popular and less effective means of development assistance. Donors and aid recipients are more interested in reforming aid practices and making aid less fungible but more effective. Would the multi-donor budget support be the means to realize this long-awaited dream? Or does MDBS merely represent one of the many policy prescriptions of the donors which, more often than not, make little difference to poverty. The next section outlines some of the benefits of MDBS versus tied aid.

3.2 Direct budget support

Budget support is a form of programme aid. Programme aid is an umbrella term covering budget support, debt relief, and balance-of-payments support. Svensson (2000) defines direct budget support as funds channelled through local accounting systems directly to partner governments; it is not linked to specific project activity and is quickly disbursed. Budget support is a financial aid programme and may take two forms (i) general budget support, and (ii) specific budget support, i.e., health and education. General budget support refers to financial assistance or contribution towards the overall budget and conditionality is directed towards policy measures which relate to the overall budget priorities. Within this category, funds may be spent on certain sectors but there is no formal limitation as to where they should be spent. On the other hand, sector budget support comprises financial aid targeted at a discreet sector or sectors, with any conditionality relating to these sectors. Normally, government accounting may be augmented with additional sector reporting.

4 The multi-donor budgetary support system (MDBS) in Ghana

To overcome the problems associated with isolated projects, the development partners⁵ and the government of Ghana agreed on an aid package known as the *multi-donor budgetary support*. Its main goal is to ensure a continuous flow of aid to enable the government to finance its poverty related expenditures. Unlike direct budget support, MDBS aims to harmonize the policies and procedures of the development partners (DPs) in order to minimize transaction costs for the recipient country.

The Framework Memorandum (FM) was signed in March 2003 between the government of Ghana (GoG) and the DPs. According to the agreement, the FM will be supplemented with individual arrangements between each DP and the GoG but the contents of each individual funding arrangement is to be compatible with the spirit and provisions of the FM. The individual agreements, however, do not constitute international treaties. The MDBS is open to all development partners wishing to

⁵ Mainly, the African Development Bank, Canada, Denmark, European Union, Germany, The Netherlands, Switzerland, United Kingdom, and the World Bank. Between 1990 and 1994, the World Bank contributed 37.2 per cent of total ODA to Ghana while the rest contributed the following proportions: Canada (6.5 per cent), Denmark (1.8 per cent), EU (n/a), Germany (6.1 per cent), Netherlands (2.8 per cent), Switzerland (n/a), and UK (6.99 per cent). Japan was the single largest contributor (16.4 per cent). Computed from Harrigan and Younger (2000: 199).

participate but this does not imply that all participating DPs are obligated to provide resources in any given year. The spirit of the FM must be respected (Framework Memorandum 2003).

MDBS's main goal is to harmonize the policies and procedures of the DPs in order to minimize transaction costs for the government. This is to be achieved by (i) agreeing on a common benchmark against which performance is assessed, (ii) improving dialogue between government and the development partners, and (iii) conditioning funding commitments and disbursements on the achievements of the agreed targets.

The operational framework of the MDBS is to be in two stages: first, the Ghana Poverty Reduction Strategy (GPRS) is to detail the poverty reduction strategy of the government of Ghana. Second, the medium-term expenditure (MTEF) budget process provides the instrument for allocating resources according to the GPRS priorities and the resource envelope.

Progress assessment of the MDBS is to be based on the goals set by the government within the GPRS. The FM stipulated that for 2003 the progress assessment framework be based on two matrices, namely, the MDBS policy matrix (EU and bilaterals) and the World Bank Poverty Reduction Support Credit. Both matrices are to be subject to separate arrangements, but it is hoped that all FM participants adopt the use of a single matrix based on the GPRS. There will be a common review process for all the DPs, and participants will meet according to an agreed schedule to jointly review the implementation and attainment of the objectives.

Under the MDBS, the government of Ghana, subject to availability of funds, is to ensure the following:

- i) implementation of the GPRS,
- ii) that total expenditure and sector allocations effectively reflect the government's poverty reduction commitment and that the budget is comprehensive;
- iii) the provision of agreed reports to DPs;
- iv) semi-annual coordination and organization of MDBS meetings, in conjunction with the mini-CG (section 2); and
- v) the coordination and organization of joint assessment meetings.

The development partners, on the other hand, would be committed to working in partnership with the GoG to facilitate the implementation of the GPRS through both direct budgetary support and complementary support provided through the DPs' wider development cooperation programmes.

The DPs would:

- i) support the implementation of the GPRS by advising the government of planned budget support with indicative commitments for the following years. However, actual commitments are to be identified in individual bilateral arrangements between each DP and the GoG;

- ii) work towards achieving the goal of a programmatic approach within a common framework; and
- iii) endeavour to coordinate the timing of disbursements to government's budgetary requirements.

The FM outlines provisions for settling disputes, and differences arising with regard to the MDBS are to be settled through dialogue and consultation between the GoG and DPs. The government and each DP are to consult with other FM participants whenever there is discussion to suspend or terminate all or partial support to the GPRS. If a DP takes action to invoke remedial measures or withdraw support, the GoG, in consultation with other DPs, would make necessary programme revisions to ensure that the expenditure framework matches available resources.

Another key feature of the MDBS is the provision of technical assistance. The DPs have proposed a flexible and responsive technical assistance programme, which allows the GoG to identify, budget, monitor and evaluate technical assistance. The unique feature is that all technical assistance is to be programmed and budgeted for in a manner similar to any other resources, regardless of the source of funds.

Since the signing of the FM, the DPs have started providing support towards the GPRS. In June 2003, as part of its contribution under MDBS to Ghana, the World Bank made US\$125 million available for disbursement in one tranche in July to support the implementation of the agreed poverty reduction reform programmes stipulated in the GPRS and the 2003 budget. The reform programmes are grouped into three broad areas: (i) promoting growth, incomes and employment; (ii) improving service delivery for human development, and (iii) improving governance and public sector.

Given that the conditions have been set for the MDBS to become operational and the funds have started to trickle in, would the MDBS make any significant in-roads towards poverty alleviation? The next section examines the likely gains to be derived from the MDBS.

4.1 Possible gains from MDBS

The multi-donor budgetary support system—if properly planned, coordinated and well implemented—is likely to offer considerable benefits.

Off-budget spending⁶

The MDBS would minimize off-budget spending which usually occurs because of inadequate government-partner planning for re-current expenditures. Off-budget spending is common in aid-dependent countries, where a number of specific projects, especially within the health and education sectors, are financed by donors through sector ministries. This makes it almost impossible for the government to track these expenditures and they often distort the national budget. However, with MDBS, a part of the donor inflows are put into a consolidated fund to be used at the discretion of the

⁶ Defined as 'below the line' expenditures of donor funds given to sector ministries of a country. These expenditures are not incorporated in the national budget and audited reports are not sent to the ministry of finance.

government to finance the development expenditures outlined in its poverty reduction strategy paper (PRSPs) or national budget. Hence MDBS synchronizes aid flows and private flows. Furthermore, donors can help set up a common mechanism for coordinated delivery of programme aid. This in turn minimizes the off-budget spending and eliminates distortions created within the aid delivery system.

Using local capacity systems

The MDBS is gaining popularity because it utilizes local systems and capacity, helping to build local potential. More often than not, governments are faced with an absorptive capacity constraint for project aid. In Ghana, the administrative capacity of certain ministries, departments and agencies is weak due to the lack of skilled personnel. Project aid often worsens the already poor state of affairs, attracting key people as a result of better pay and other factors not prevalent in the civil service. MDBS, on the other hand, offers the opportunity to utilize the accounting systems of partner governments, encouraging staff to remain at their posts and strengthening local skills. Some partners of the MDBS system in Ghana, e.g. DFID, have indicated their willingness to complement budget support with technical assistance to improve local audit systems.

Transaction costs

Projects aid is often hindered by high transaction costs because submitting separate reports on a range of donor-funded projects is costly. Also, numerous meetings between government officials and donors can be time-consuming and significantly add to the cost of aid. For instance, donors fund over sixty thousand development projects and programmes globally, for which separate and timely reports are required for each donor, often exceeding the capacity of the aid-receiving countries. This shortcoming can be avoided with MDBS since it applies a unified approach that does not require separate reporting. With MDBS, individual systems and procedures are simplified and donors agree on a common format with regard to content and frequency, so that a single periodic report per project is sufficient to meet the requirements of all partners. To achieve this, donors would need to simplify their monitoring and reporting systems.

Country ownership

Project aid is generally made up of different projects funded by different donors. This often comes with very little country ownership and may not support the government's priorities. However, with budget support, there is greater opportunity for donor coordination in supporting government priorities and allowing the government a greater degree of ownership. But would MDBS lead to country ownership of government policies and programmes? A programme is classified as country-owned if the objectives and policy choices of the recipient of aid are prioritized and implementation is expected to be a function of ownership. However, where donor objectives dominate, aversions are likely to be strong. In the case of Ghana, would the donor community allow the government's poverty reduction strategies and policies to dominate within the MDBS framework or would the objectives of the donor be moulded into future policy documents (as has been the case with the GPRS)?

It is strongly suggested that policies of aid receiving countries should be the main poverty reduction strategy within the MDBS. In a WB study of 81 adjustment credit

cases, Johnson and Wasty (1993) find that ownership was a significant factor in programme outcomes. In the absence of local ownership, governments evade commitments and renege when the opportunity arises. In the case of Ghana, the GPRS is the main policy strategy for the MDBS and therefore ownership rests solely with the government, although there were reported incidences of donor influence during the design stage.

Donor influence and policy change

Donors want to influence the targeting of public expenditure towards the poor and at times towards more general economic and social reforms. Donors, therefore, use conditionality to influence policy change. Killick (1998) identifies two types of policy conditionality. One is the *hard core* conditionality, i.e., the policy changes to be introduced as a prerequisite to assistance. In this case, conditionality may be viewed as the use of monetary power to promote donor objectives. *Pro forma* conditionality, on the other hand, refers to mutually agreed or non-significant or formalistic provisions, which both parties find convenient to include in a programme.

The 1980s saw a remarkable increase in donor conditionality in developing countries (discussed in section 2). But the high-conditionality adjustment programmes of the IMF and World Bank have had minimal positive outcome, even though their general approach to policy elsewhere has been associated with remarkable economic performance. It can be argued that there is little that donor conditionality⁷ can achieve if the willingness to take action is missing; conditionality then is superfluous and counter-productive because it undermines local ownership—exactly the kind of situation that the MDBS process in Ghana aims to avoid. Conditionality under the MDBS needs to be transparent; its intentions are to be made clear to the relevant spending agencies and above all, the government must have the effective means to monitor expenditures and budgetary processes.

The key issue, however, in the minds of the Ghanaians, is the extent to which the MDBS would allow donors to influence policy. Would donors be able to use their financial power to influence policy? Could MDBS minimize the occurrence of policy reversals like the withdrawal of the 20 per cent import duty on rice and poultry? Or would donors continue to dictate policies such as the sale of Ghana Commercial Bank?

Predictability of aid flows

Aid flows to developing countries are unpredictable and very volatile. There are diverse views on the effects of aid volatility on the government's fiscal behaviour and growth. Lensink and Morrissey (1999) find that the effect of aid on growth is insignificant unless some measure of aid uncertainty is factored into the analysis. In a related study, Lensink and Morrissey (2000) argue that aid volatility is likely to substantially attenuate the growth effects of aid. Gemmill and McGillivray (1998) also find that aid shortfalls are usually followed by a reduction in government spending, increases in taxes, or both. In an empirical study, these authors find aid to be significantly more volatile than fiscal revenue. Collier (1999), on the contrary, finds aid in Sub-Saharan Africa to be less volatile than tax revenues as well as counter-cyclical.

⁷ This refers to 'hard core' conditionality which is often meant to promote donors objectives

A related study by Bulir and Lane (2002) argues that while all revenues are subject to some degree of uncertainty, the magnitude of uncertainty for aid is somewhat different from that of domestic tax revenue. The magnitude tends to be higher in the case of Ghana and this has repercussions on pro-poor expenditure. It is worth mentioning that the difference lies in the spending processes of donor countries and the design of conditionality. Aid inflows to aid-dependent countries have become unpredictable and tend to distort the government budget. Shortfalls in aid inflows have become more frequent, and this questions the consistency of donors. Much of the support is allocated different 'pots' and aid recipients are unable to meet the donor requirements and conditionalities to trigger disbursement (Aryeetey and Cox 1997: 76).

In Ghana, delays and shortfalls in donor inflows have forced the government to cut back on development expenditures. At times, the shortfalls have resulted in unplanned domestic financing or in non-concessional external borrowing, with serious repercussions on future budgeting. Table 2 shows that, except for 2001 when shortfalls in inflows were less than 2 per cent, volatility in expected inflows has been very high.

Table 2
Actual and projected inflows to Ghana (billions of Cedis)

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

Source: Government of Ghana's Annual Budget Statements, 1998-2003

Pro-poor budget setting

Projects aimed at poverty alleviation often have limited impact outside the project area and target group. Hence, budget support, which works hand in hand with dialogue, aims to re-shape the budget setting process in favour of the poor by planning the budgets better, and ensuring that expenditures are related to resource availability and outputs. This will help to re-shape government spending towards the poor (Foster and Fozzard 2000). Budget support can also introduce conditions to help protect the social services and, more generally, pro-poor measures.

4 Conclusions

The paper examines whether the multi-donor budgetary support in Ghana is a better alternative to tied aid in influencing aid effectiveness. It argues that Ghana had received significant amounts of foreign inflows, particularly during the 1980s, which had resulted in modest growth and poverty reduction. In order to increase aid effectiveness, the government of Ghana and its development partners have agreed on a framework memorandum, which would eliminate some of the problems associated with aid, such as tied aid and other project support. The *multi-donor budgetary support* (MDBS), as it is called, might reduce transaction costs, take advantage of donor accounting systems to build local capacity, promote country ownership of policies and programmes, ensure pro-poor spending and above all make aid inflows more predictable. Commendable as

this may seem, there are a number of issues that need to be solved to make the programme effective.

First, the MDBS is to operate in tandem with other forms of project aid. The problem with this arrangement is that the mix between the MDBS and other forms of project aid would not reduce transaction costs significantly enough to make aid very effective. There may be some gains but the benefit would be much greater if aid policies were synchronized so that other forms of project support were to operate similarly to the MDBS. Second, not all donors have signed the agreement, including Japan, one of the biggest donors. Japan may wish to continue providing food aid and other forms of project support, which often have high transaction costs.

Equally disturbing is the fact that there is very little information in the Framework Memorandum to indicate that the MDBS could make aid inflows more predictable. Aid volatility is a major factor of aid ineffectiveness. This therefore introduces the question of how would the MDBS make aid more effective. Another concern is the fact that donors are likely to be influenced by one another. In 'comparing notes', they may restructure their aid and possibly cut down on the grant component. So far, this scenario has not happened; the first move, made by the World Bank, was generous.

In conclusion, the MDBS concept is innovative and could work in Ghana, but this requires trust, as well as a carefully designed and coordinated effort on the part of the government and the development partners. Moreover, the success of the MDBS depends crucially on measures to reduce the country's debt burden; without these, Ghana would be compelled to use inflows for debt service. It is also suggested that policy conditionality should be limited to issues that arise from the country's own poverty reduction strategies. In other words, policies should be focused on the GPRS⁸ so as not to provide grounds for the government to renege on the agreement. Another important issue needing careful consideration is the fact that the disbursement of loans, particularly the second tranche, is based on the government complying with the 'trigger' or conditionality, but given that this coincides with elections year, would the MDBS ensure a guaranteed inflow? Finally, the MDBS should minimize donor influence, especially on policy reversals.

⁸ Both the budget setting process and the preparation of the GPRS involves Parliament. However, it has been argued many times that the PRSPs went through series of modifications by the IMF and the World Bank before they were officially accepted. This creates a divide between authorship and ownership and if government is not committed then the programme becomes ineffective. See Morrissey and Verschoor (2003).

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