

23 December 2010

Submission to the European Commission's green paper on the future of budget support to third countries

This submission is based on the combined experience of Global Witness and the International Budget Partnership. With a view to improving governance standards and domestic revenue generation, and to reducing wastage and corruption, **we believe the EC should use its budget support policy to promote better transparency and accountability in aid recipient countries.** Specifically, the EC should do the following:

- Expand the underlying principles on which the EC bases its decision on whether or not to grant budget support to include a commitment to transparency.
- Explicitly link the provision of budget support to a commitment to and attainment of basic transparency requirements. At a minimum, these should cover: (a) budget transparency;¹ and (b) natural resource governance transparency.²
- Adopt specific, measurable and time-bound indicators to monitor improvements in these areas.
- Before budget support is provided, identify and agree the process which will be followed if indicators are not met.

¹ Budget transparency relates to the timely and regular release of detailed and reliable information on the country's budget by the government, throughout the different phases of the budget cycle, so that the public can hold government accountable for how it handles public resources.

² Natural resource governance transparency applies here to the set of strategies aimed at improving the accountability of governments and private companies during the licensing, exploration, contracting, extraction, revenue generation of natural resources.

- Provide additional resources to build capacity to analyse and interpret budget information within domestic accountability institutions.
- Improve the transparency of its own aid flows and their compatibility with country budget systems.

Global Witness is a London-based NGO which works to expose the links between conflict, corruption and natural resources. Our work has spanned resource-rich countries in Africa, Asia and South America over the past 15 years. Our investigations and campaigning were a key catalyst in the creation of the Kimberley Process, to tackle the trade in conflict diamonds, and the Extractive Industries Transparency Initiative (EITI), to encourage transparency over payments and receipts for natural resource revenues. We were co-nominated for a Nobel Peace Prize in 2003 for our work on conflict diamonds, and were awarded the 2007 Commitment to Development Ideas in Action Award, sponsored jointly by Washington DC-based Centre for Global Development and Foreign Policy magazine.

Since 1997, the International Budget Partnership has collaborated with civil society around the world to analyse and influence public budgets in order to reduce poverty and improve the quality of governance. We work with think-tanks, community-based organizations and social movements in over 100 countries that undertake “applied budget work” (participation in budget processes in order to improve budget systems, policies and outcomes). In order to achieve our goals, we work by: (a) building budget analysis and advocacy skills in our partner organizations; (b) measuring and promoting budget transparency worldwide through the Open Budget Index, which is published every two years; (c) providing financial assistance for civil society budget work; (d) enhancing knowledge exchange among civil society budget groups; and (e) building vibrant international and regional budget networks.

As NGOs which work closely with communities in developing countries to create better conditions for sustainable development, we share the European Court of

Auditors' concerns that EU taxpayers' money is well spent in the fight against poverty. The opportunity to input into this Green Paper on budget support is therefore welcomed. The comments and recommendations below refer mostly to sections 4.2 and 4.3 of the Green Paper, and to Questions 5, 7 and 8.

Why should promoting transparency in aid-recipient countries be a core concern for the EC's budget support programmes?

Recent years have seen an increasing consensus on the role played by a lack of transparency and corruption in hindering development. The Paris Declaration on Aid Effectiveness, for example, states that *“corruption and lack of transparency [...] impede effective resource mobilization and allocation and divert resources away from activities that are vital for poverty reduction and sustainable economic development”* (OECD, 2005:2). As a corollary, *increased* transparency is now seen as key to counteracting these trends through enabling greater accountability between government and citizens. Existing evidence illustrates important associations or positive correlations between greater transparency and better governance, reduced corruption, and better socio-economic and human development indicators (Kolstad and Wiig 2009, de Renzio et al. 2009, Bellver and Kaufmann 2005).

The link between better transparency and lower levels of leakage and corruption can also contribute to the increased effectiveness of budget support programmes. In more transparent countries, donor resources channelled through the recipient country's treasury are less likely to be wasted and captured. Evidence from Uganda, for example, shows how the percentage of education grants reaching schools at local level increased dramatically after the government started publishing grant information in local newspapers (Reinikka and Svensson 2003). As education is one of the sectors that budget support operations often target, improved transparency standards can reduce the likelihood of aid funds being lost or diverted from their intended use, increasing their development impact.

Promoting transparency also makes sense for EU business investment because it helps to address the corruption which can lead to volatility in availability and pricing, greater insecurity over contracts, and increased 'informal costs', such as bribery

premiums. The EC has already acknowledged how these dynamics are negatively affecting its supply chain of essential natural resources, and is developing a strategy to address this through its Raw Materials Initiative.

Whilst the EC supports a number of promising international initiatives which promote good governance and transparency,³ these need further strengthening and expansion upon. The revision of its budget support programmes provides an opportunity for the EC to further promote and support increased transparency as part of a more systematic and robust response to the challenges of poor governance. This includes both the more specific challenges associated with the transparency of natural resource governance, and more general issues related to overall budget transparency.

The importance of natural resource governance transparency

The negative impact of corruption and a lack of transparency is particularly felt in resource-rich countries, where an increasing body of research points towards bad governance and weak institutions as the main factor leading to the *resource curse* phenomenon.⁴

Natural resources provide the greatest potential for financing development in many of the world's poorest countries. In 2008, exports of oil and minerals from Africa were worth roughly US\$393 billion, nearly nine times the value of international aid to the continent (US\$44 billion).⁵

Instead of contributing to development and prosperity however, often these natural resources have the opposite effect – increasing poverty and suffering. In some countries, such as the Democratic Republic of Congo, competition over minerals has fuelled armed conflict and financed armed groups responsible for widespread killings of unarmed civilians, rape, torture, and the recruitment of child soldiers. In others, such as Turkmenistan, revenues from gas exports have bankrolled corrupt and unaccountable governments, and underwritten systemic human rights violations.

³ Such as the Extractive Industries Transparency Initiative, the Kimberley Process and FLEGT.

⁴ See, for example, Eifert et al. (2003), Ross 1999, Rosser (2006) and (Dietsche 2007).

⁵ OECD, *Gross official development assistance in 2008*, <http://www.oecd.org/dataoecd/47/55/42458670.pdf>; World Trade Organisation, *World Trade Statistics 2009*, p.42.

Despite the centrality of these resources to generating sustainable economic growth in countries receiving EC budget support – and their potential to skew citizen-state relations – the management of these resources is generally not prioritised within budget support agreements. Often, they are treated as a second-string issue behind the delivery of essential services such as education and healthcare.⁶

Case study example: Uganda

Uganda is an example of a developing country with potentially transformational oil reserves, but which is, for now, dependent on aid. Since 2008, major discoveries of oil have been made around Lake Albert in Western Uganda. According to the World Bank, these oil finds have the potential to double government revenue within 6 to 10 years and to constitute an estimated 10-15 percent of gross domestic product (GDP) at its peak.

Uganda's donors have collectively provided more than US\$19 billion in development aid to the country over the past 25 years. Although the proportion of aid given to the government's annual budget has been declining, in 2010 pledges still amounted to 35 percent of total government income. The advent of oil presents a challenge for the donors' development legacy. If managed well, the revenue from oil could lift Uganda from one of the world's poorest countries to middle-income status. If managed poorly, and the country is plunged into the *resource curse* scenario, the impact across all development indices will be negative and the country's ability to meet its own poverty reduction strategy and stability will be undermined.

Donors therefore have a big stake in ensuring that the resource wealth about to come on tap is used for developmental purposes. The signs are not good, however. Global Witness' research has identified a number of red-flag warning signals in the country's oil sector which should seriously worry its donors and its citizens. These include a

⁶ Global Witness is only aware of two exceptions to this – Ghana and Cambodia – where the EC has developed a budget support framework which takes into account some of the country's natural resource sectors.

lack of transparency and accountability throughout the awarding of concessions, contracts and signature bonuses.⁷

Given that 68 percent of aid to Uganda is currently directed through the budget support programme, this is the obvious starting point for donor co-ordination. When Global Witness met with a selection of donors in June 2010 however, none had considered this option. The draft Joint Performance Assessment Framework, dated July 5th 2010, does briefly mention oil, but only in reference to revenue accounting.

When the budget support framework is reviewed in 2011, the EC should promote the incorporation of basic transparency and governance benchmarks for the oil and gas sector within Uganda's joint budget support framework in line with the government's own National Development Plan. Disbursements of future aid should be linked to performance against these benchmarks.

The importance of overall budget transparency

The governance of natural resources presents very stark transparency challenges. These are also present not only with relation to other sources of government revenue (such as foreign aid, for example), but also, and more importantly for development purposes, with relation to the allocation and spending of public resources for delivering basic services. For this purpose, the production of timely, comprehensive, accurate, and accessible data on government budgets is a critical goal that needs to be on the agenda of governments, development institutions, and civil society alike.

Budget transparency and public participation can enhance the credibility of policy choices and the effectiveness of policy interventions. They are also essential to monitoring progress toward the achievement of international development commitments, such as the United Nations' Millennium Development Goals (MDGs). Finally, public availability of budget information allows the public and civil society organizations to hold government accountable. In Tanzania, for example, a civil society group called HakiElimu used budget analysis and advocacy to press for

⁷ For further information and references see *Donor Engagement in Uganda's oil and gas Sector: an agenda for action* at www.globalwitness.org

improvements in the quality of education.

In aid-dependent countries, where foreign aid may account for more than half of the national budget, and often for most of public investment, donor agencies are inevitably very important actors, but too often they have not taken transparency and accountability issues seriously enough. Technical assistance for budget reform programmes rarely includes a transparency component. Transparency-related conditions linked to budget support programmes are similarly uncommon. Assistance to domestic accountability institutions such as parliaments, audit institutions, civil society and the media is still incipient, and donors' own transparency practices are often unsatisfactory, preventing governments from adequately reflecting foreign aid flows in the country's budget.

How can the EC's budget support programmes better promote transparency?

Given the important role that transparency can play in improving the use of public resources, from natural resource revenues to foreign aid flows, and their effectiveness in achieving development outcomes, donor agencies like the European Commission should play a much more proactive role in promoting it. Budget support programmes provide a number of natural entry points, given their focus on providing direct support to the recipient country's budget.

Ideally, transparency reforms should be driven by domestic country processes. Externally-imposed conditionality, as practised in the past, has not only been inappropriately applied, but also has often proven to be ineffective and counterproductive. In addition, the claim that donors can influence the development orientation of recipient governments by linking their support to specific outcomes is fraught with potential contradictions and still needs to be validated by solid empirical evidence. However, in countries where the state is unaccountable and/or unresponsive and has ceased to operate in the interests of its citizens, relying on internal domestic country processes is not sufficient to ensure that development aid contributes to poverty reduction. In these contexts, the provision of EC budget support without governance requirements only serves to support the status quo. Transparency provides

a good entry point for the European Commission to create the *conditions* for better development performance, rather than attempting to affect specific policy choices.

Consequently, we think that **the underlying principles on which the EC bases its budget support frameworks should be expanded to explicitly include a commitment to transparency, as well as human rights, democracy and the rule of law. Budget support recipients should be selected on the basis of the existence of clear political support and domestic drivers for these principles.**

Moreover, **the provision of budget support should be explicitly linked to a commitment to and attainment of basic transparency requirements. At a minimum, these should cover (a) budget transparency and (b) natural resource governance transparency.**

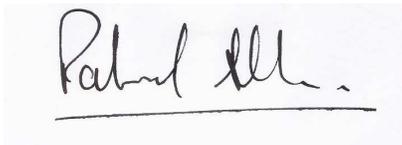
To support this, the EC should **adopt specific, measurable and time-bound indicators to monitor improvements in transparency, accountability and governance. In order to support domestic accountability these metrics or benchmarks should be monitored in consultation with domestic civil society. In the natural resource sector, the EC should also employ the necessary expertise to ensure the development of nuanced and appropriate indicators which take account of the entire resource-value chain of production.** For example, this should include indicators to ensure transparency over the awarding of rights to access a resource, beneficial company ownership or contracts. Moreover, **before budget support is provided, the EC and partner governments should explicitly identify and jointly agree a credible process which will be followed if indicators are not met.**

Given the main focus of budget support programmes on the executive arm of government, the EC should **provide additional resources to build capacity to analyse and interpret budget information within domestic accountability institutions such as parliaments, audit institutions, civil society and the media, and work through them as much as possible, rather than set up parallel reporting and accountability mechanisms that undermine their role.**

Finally, given the overall lack of transparency of donors' own aid flows, the EC should **improve the transparency of its own aid flows and its compatibility with country budget systems. This includes systematically publishing and disseminating budget support frameworks and their related information, including planned and actual disbursements and agreed performance indicators.**

We would welcome the opportunity to discuss any of the ideas with your office further. A member of staff will be in touch within the next month to follow up.

Yours Sincerely,

A handwritten signature in black ink, appearing to read "Patrick Alley", written over a light blue horizontal line.

Patrick Alley
Director
Global Witness

A handwritten signature in black ink, appearing to read "Warren Krafchik", written in a cursive style.

Warren Krafchik
Director
International Budget Partnership