

Illusions and Disillusions with Pro-Poor Growth

– Poverty Reduction Strategies
in Bolivia, Honduras and Nicaragua

ROB VOS AND MARITZA CABEZAS



In the three countries studied in this report, poverty is serious in the densely populated urban areas, but even more alarming in rural areas where it affects women particularly severely. One major stakeholder complaint in these countries is that, in the poverty reduction strategy design and during the process of national consultation, macroeconomic policies and broader economic reforms were not positioned in line with poverty reduction objectives.

The report shows how vague definitions of “pro-poor growth” strategies actually are. Some of the credibility problems experienced by the PRSP process are directly connected to this apparent lack of consistency between economic policies and poverty reduction. Furthermore, vis-à-vis the new agendas of second generation strategies, civil society has lost space. Other major problems relate to insufficient action as to e.g. the need for land reform, to gender issues and to the threat of debt insolvency. These problems are exacerbated by lack of stability in aid flows, excessive policy conditionality and insufficient coordination among donors.

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Sida**studies**

Foreword by Sida

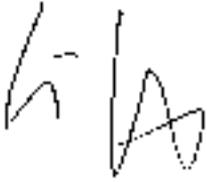
Poverty reduction is the primary goal of Swedish development cooperation in Latin America and elsewhere. The emergence of the PRSP instrument in 1999 was a promising step towards country-led strategies aimed at fighting poverty. Sida, the Swedish International Development Cooperation Agency, asked the Institute of Social Studies (iss) in The Hague to independently monitor and evaluate the PRS processes in three Latin American countries. The countries chosen are three of the poorest countries in the region – Bolivia, Honduras and Nicaragua. They are all eligible for international debt relief and Swedish development cooperation maintains a strong presence there. The studies were initiated in 2003 and will continue for a period of five years. Every year a country report is elaborated for each of the three countries, evaluating the poverty reduction strategy processes and results at national level. In addition, thematic reports and background studies are produced to highlight certain topics and themes common to all three countries. Themes are selected depending on the status and progress of the PRS over time, as well as on how emerging issues are addressed. The evaluation as such is thus carried out over a longer period which provides a unique time perspective on the development of the instrument and its results at country level.

The present report is a synthesis report summarising findings made in 2004, based on case studies in each of the three countries. A comparative analysis of these experiences is presented, highlighting lessons to be learned for governments, civil society and the donor community. “Pro-poor growth” is the central theme of this report. The report analyses how the relationship between growth and poverty reduction is defined in the three PRSS and whether the proposed policies can effectively promote pro-poor growth. The initiated reader will know that much has happened in the process since the report was originally published, but the findings will hopefully serve as reference and experience for others to learn from.

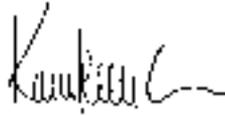
Sida initiated this process knowing that the PRS instrument was about to change. It has – and the results highlighted in this report are often discouraging. Still, we believe that the effort of monitoring and evaluating poverty reduction policies in our partner countries, no matter what label they bear, will remain relevant. We also believe that independent research and qualified debate on the PRS experience in Latin America is essential. We are happy to know that these studies are considered a joint resource and reference among donor colleagues and partners in the region and

have consequently made an effort to disseminate the results widely in partner countries and internationally.

Through this report and forthcoming ones other important themes for poverty reduction will be examined. Budgeting for poverty reduction and institutional capacity to implement strategies will be such themes. Hopefully the regional and thematic focus could be useful in bringing together country experiences and in facilitating learning and exchange between countries in the region and elsewhere.



Göran Holmqvist
Director



Karin Metell Cueva
Project Coordinator

Department for Latin America
March 2006

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Executive Summary

The Poverty Reduction Strategy Paper (PRSP) framework was introduced in 1999 creating great expectations for the Heavily Indebted Poor Countries, HIPC's. It was not only visualized as a framework to use in order to pair debt relief with poverty reduction, but also regarded as an opportunity to introduce a participatory process that would tailor the strategy to the country's needs, assuring ownership and long term viability. Improved budgeting procedures would guarantee transparency and accountability in the policy process, allowing a more efficient allocation of development cooperation funding.

This report compares experience of the PRSP process in Bolivia, Honduras and Nicaragua in 2003 and 2004.¹ This experience of implementing poverty reduction strategies plus elements of uncertainty and continuous changes of plans make it extremely difficult to evaluate PRSPs in terms of their outcomes. For now, all that is possible is to assess the *process* of strategy design and implementation. The report pays specific attention to how the strategies propose to achieve pro-poor growth and also raises questions as to what extent the PRSP will effectively redirect the economic growth process to the greater benefit of the poor. The analysis suggests this is no trivial matter as there is limited consensus as to what pro-poor growth means and what effective pro-poor policies are.

The PRSP Processes

The PRSPs take a comprehensive approach towards poverty reduction. In practice, however, this has led to broad-ranging plans generally without much prioritisation of actions and clear indications on how these interventions are expected to meet the poverty reduction targets. The revised PRSPs (as in Honduras) or the new 'National Development Plans' (as in Bolivia and Nicaragua) also suffer from this lack of priorities, leading to the conclusion that they are not actual strategies but rather a list of good intentions. This lack of prioritisation makes decision making more complicated when adjustments are required under volatile economic conditions which, time and time again, demand the imposition of new budget constraints. The PRSPs do not present a strong connection between proposed interventions, budget allocations for poverty reduction programs and expected outcomes.

¹ For an update of PRSP reports for 2005 see www.iss.nl/prsp

Furthermore, the weak foundations of the PRSPs in the three countries have tainted their future with uncertainty. The PRSP processes continue to face a number of challenges that originate from weaknesses that emerged early on in the process: the limited time that was devoted to the design of the programs, the weak transmission channels between the design and implementation of the strategy and the absence of dialogue regarding sensitive issues. These factors have contributed to the limited sense of ownership and actual participation in the strategies, thereby weakening their political support. This places constraints on the continuity of the process. In fact, civil society has lost space vis-à-vis the new agendas of the second generation PRSPs. Attention paid to cross-cutting issues such as gender has lessened even further.

In their short-lived existence, the PRSPs have undergone many changes. This could be a good sign, part of a dynamic process of policy formulation, but in fact it has been a source of confusion as government changes in Bolivia and Nicaragua brought new National Development Plans which covered the same ground as the PRSP. This has left the status of the original PRSP unclear. The poverty focus of the national plans in these two countries also appears to have weakened as the emphasis on aggregate economic growth objectives has taken centre stage. Honduras has managed to build consensus (although it may be temporary) on the fulfilment of the performance criteria behind the economic program. Nicaragua and Bolivia have not been able to gain acceptance for PRSP programs and policy action in a reformed budgeting process, which would have ensured sufficient resources for anti-poverty programs. Such acceptance would have allowed more immunity towards political sea changes. This lack of progress towards more result-oriented budgeting hampers the transparency and accountability of the use of funds for the PRSP, as well as the monitoring of the impact of fiscal policy on poverty reduction.

Honduras has managed to pass laws which guarantee consistency between the PRSP and the national budget. The challenge now is to make this work in practice and protect budgets for poverty-related spending.

Macro-economy, Financing and Debt Solvency

The uncertain future of the PRSP process also stems from the persistent instability and vulnerability of the three countries' economies. Economic volatility remains the order of the day. A comprehensive poverty reduction strategy must be accompanied by a coherent mid-term macroeconomic scenario. This has proven to be another weak link in the PRSP process in

the three countries, with three negative consequences for the implementation process:

- 1) The focus on short-term macroeconomic adjustment and the exclusion of macroeconomic policies from the PRSP agenda has alienated important civil society actors from the PRSP process and has been part of the weak sense of national ownership.
- 2) It has continued to nourish the perception that development financing is still subject to the traditional IMF conditionality.
- 3) It has kept economic growth at the centre of macroeconomic policy goals. How aggregate growth will lead to the targeted degree of poverty reduction remains rather unspecified.

The three countries have faced a decline in their growth rates and a permanent vulnerability to shocks. More specific problems such as the gas reform in Bolivia, the impact of rising international oil prices for Honduras and domestic debt in Nicaragua pose increasing threats to the fiscal and macroeconomic situation.

Adjustment to such changing conditions while preserving priority for PRSP targets is not helped by the lack of compatibility between the PRSP and the conditions of the IMF Poverty Reduction Growth Facility (PRGF). The PRGF – once approved – triggers funding by other donors, but continues to emphasize short-term macroeconomic targets without sufficient consideration of the longer time span needed to pursue the necessary investments and structural changes for ambitious growth and the poverty reduction agenda. Macroeconomic instability thus also implies instability in the financial resources available for the strategy in the medium-run, thereby reducing the viability of the PRSP. Additionally, risks have become more important than the progress achieved thus far in implementing the PRSP.

Once countries reached the culmination point in the HIPC framework, this does not imply that their debt solvency problems are over. When it comes to funding poverty reduction strategies, donors have no defined preference for donations or loans. This is an issue that still needs to be debated and the specific situation of poverty in each country and its growth capacity should be taken into account. Both Nicaragua and Bolivia have reached their culmination points in the HIPC initiative and the threat of

debt insolvency has not disappeared as external borrowing continues to be an important source of financing in countries proposing Second Generation PRSPs. Weakness of the financial system remains an issue in the three countries, as are recurring public debt sustainability problems despite debt relief, fiscal fragility, corruption and how decentralization and pension systems are implemented.

'Pro-poor' Policies

There is no consensus among academics or national policy makers about the contours of a pro-poor growth strategy. Donors agree that the link between growth and poverty reduction requires more in-depth study. A recent report from the IMF which evaluates the PRSP experience puts it as follows: "...it is worth emphasizing at the outset that knowledge of the links between policies and growth remains limited and understanding of the links between policies and poverty reduction even less so." This implies that quite a bit of experimenting with which policies work and which do not seems unavoidable. It also implies that 'one-size-fits-all' approaches or policy solutions based on cross-country experiences simply will not do. The strategies will need to consider country-specific institutional and structural characteristics as a starting point.

Two definitions dominate the discussion. The first concept speaks of pro-poor growth when the income of the poor increases at a higher rate than that of the non-poor. The second states that the poor should benefit in absolute terms, therefore depending only on the rate of change of poverty. The objective of a pro-poor growth strategy would then be to reach an economic growth path producing a maximum of poverty reduction. The first definition emphasises the need for a redistribution of incomes. The second is more concerned with poverty reduction per se, thereby closer in concept to the targets of the PRSP and the first Millennium Development Goal, which aims at halving extreme poverty by 2015. It also simplifies the analysis by centring the impact of policies exclusively on the poor. This does not imply that the second approach need not be concerned with redistributive policies. Yielding a growth process enabling "maximum poverty reduction" in most contexts will require a strong emphasis on redistribution of wealth and income. This holds true in particular for the Latin American countries characterised by high levels of initial income inequality, implying that little growth benefit tends to trickle down to the poor. For the purpose of this study we concentrate on this second definition. The report does not intend to propose a blueprint or a specific pro-poor growth strategy for Bolivia, Honduras or Nicaragua. Rather,

it simply assesses the choices made by the three countries in their quest towards this objective.

The report uses an analytical framework that has been developed to evaluate the effectiveness of policies in reducing poverty and stimulating growth. A two-by-two matrix is used to assess the relationship between poverty reduction and growth. On the vertical axis, the impact of policies on economic growth (efficiency) is measured and on the horizontal axis the impact on poverty (equity). This framework is used to obtain a classification, or 'taxonomy', of pro-poor policies as embedded in the PRSPs of Bolivia, Honduras and Nicaragua.

In *Bolivia* gas could provide the country with the best, currently available, opportunity to change its future. It offers the state the resource base for the investments required in infrastructure, redistribution of assets (credit programmes), financing of social spending and debt payment. Revenues should thus not only be used for social investments but also to foster productive activities within the country. Two major challenges must be met in order to accomplish these objectives. The first is to effectively turn gas revenues into public revenues, which requires reaching political agreement on the exploitation of gas and on how it will be exported. The second challenge regards the design of an appropriate, decision-making process on how to allocate and manage resources. The long-term outcomes of this proposal are uncertain. Not only because of the degree to which the indicated challenges can be met, but also because of the intrinsically unstable condition of the economy. The national policy dialogue, which should lead into a revised PRSP, is Bolivia's opportunity to turn this into a viable proposal.

The revised PRSP for *Honduras* seeks to enhance the economy's competitiveness through investments in infrastructure, extension of trade integration and promotion of tourism. The government expects that these actions will, in themselves, foster pro-poor growth, but aims to strengthen the process through increased social expenditure. If implemented, all these proposals combined could give rise to large-scale pro-poor growth potential. However, there is also a great degree of uncertainty about the outcomes due to concern about the effectiveness with which policies will be implemented. The taxonomy of policies for Honduras shows that a great deal of the envisaged impact would indeed stimulate both economic growth and poverty reduction. On the other hand, there are also possible outcomes that would fail to do so and result in either no growth, but some poverty reduction; growth with increasing poverty; or recession with increasing poverty. As a result, it is hard to predict what it all adds up to. Interestingly, it can be foreseen that the magnitude of these identified im-

pacts varies considerably from expected strong growth with reduction of poverty (due to expected efficiency gains from infrastructure investments in the so-called '*corredor logístico*') to strong negative effects on economic growth and poverty (resulting from unemployed resources not absorbed by sectors that gain from the Central American free trade agreement with the United States, CAFTA). Although the final outcome of these effects is difficult to predict, the important message is that no *one* single policy will yield pro-poor growth.

Our assessment of the policies included in *Nicaragua's* National Development Plan does not encourage optimism. As in Honduras and Bolivia, the strategy is promising on paper; however the potential impact of these policies is full of risk. The taxonomy gives a broader picture of the diverging paths these policies could eventually take. More economic integration through CAFTA could deliver modest pro-poor growth gains, but there are obvious losers from further relaxation of trade restrictions; in particular producers of basic grains which is a group mainly consisting of poor farmers. Unlike in Honduras, textile producers in Nicaragua will not immediately suffer from the cancellation of the Agreement on Textiles and Clothing and will keep their preferential trade status. With CAFTA they would be granted greater export quotas for textiles in United States markets. This may yield important pro-poor benefits as the textile industry in the export free zone is highly labour intensive. However, production capacity is limited and competitive expansion of textile production is clearly dependent on foreign investment. Given the fierce competition in global textile markets and Nicaragua's poor infrastructure, neither foreign investors nor potential gains from enhanced quotas will come automatically with the ratification of the free trade agreement. Investment in infrastructure should improve competitiveness in the country, but its positive impact will not be in the short run. In addition, these investment plans require high levels of upfront financing, most likely through foreign debt, which could again affect Nicaragua's debt sustainability. The development of the tourism sector could generate more employment, although it is not clear to what extent this will favour job creation for unskilled (poorer) workers. If progress can be made with land reform in Nicaragua, proposed rural development policies may make agricultural production more pro-poor. If the land tenure problem is not resolved, and access to rural credits for poor farmers cannot be ensured, (the National Development Plan being far from clear as to how to resolve these issues), then the upshot could well be that plans for agricultural development will only benefit the large scale farmers, thus doing little for poverty reduction.

Comparison of Pro-poor Growth Strategies in the Three Countries

The initial growth strategy as proposed in the PRSPs has changed in the three countries as their PRSPs have been revised. Since growth has been modest, emphasis has now turned to economic growth. Redistribution through public expenditure is thus postponed until the longer term. In Bolivia almost all hope for future growth is based on gas exploitation and in the use of its revenues for poverty reduction. In Honduras and Nicaragua emphasis is placed on increasing competitiveness and gains from trade in regional and world markets. Their poverty reduction strategies have been made almost fully dependent on achieving higher aggregate economic growth targets.

The PRSPs of the three countries pay little attention to the policy trade-offs that may emerge between the short and long-term objectives; neither do they address the issue of gaining enough support within civil society for these strategies to become politically viable. Honduras and Nicaragua rely on enhanced competitiveness, but gains in this area depend on new investments in infrastructure and human capital with returns that can only be obtained in the medium run. The PRSPs assume, in contrast, that such gains will come more or less instantaneously. This lack of attention to inter-temporal trade-offs creates doubts as to whether the financing of these investments will be sustainable and whether existing political support for the strategy will not quickly evaporate as no results become visible in the short run.

Poverty in Latin America has two different faces, serious in densely populated urban areas but more alarming in rural areas where it particularly affects women.

The PRSPs of Bolivia, Honduras and Nicaragua recognize this and put some considerable emphasis on rural development and the importance of dealing with land distribution and property rights. However, limited progress in this field can be reported in all three countries. In Bolivia, agro-industrial production chains could generate income for the rural poor, but in practice incentives are biased towards modern export farming and the lack of access to land for the poor will likely be decisive in excluding them from any gains from these rural development policies. In Honduras and Nicaragua this bias towards modern crops is even greater, leaving few alternatives for the poor as incentives for the development of off-farm activities in rural sectors are very limited. Hence, the PRSP of the three countries should include the land tenure issue as a priority and clearly identify mechanisms to include the poor in land reform.

Economic volatility and vulnerability are important sources of risk for the pro-poor outcomes of these strategies. By enhancing competitive-

ness, Nicaragua and Bolivia expect to diversify their exports and reduce vulnerability to external shocks. As already mentioned, tangible results are unlikely to show in the short run. In addition, both countries aim at strengthening (new) agricultural exports and maquila industries which are no less sensitive to world market fluctuations than traditional exports. For Bolivia this risk is even greater as it plans to collect its revenues from a single product, natural gas, sensitive to highly volatile world oil prices. It calls for the creation of an efficient stabilization fund, but such a fund has yet to be created.

It is noteworthy and worrisome at the same time that the three PRSPs pay so little attention to mechanisms that could deal with volatility of output growth and government revenues and soften the impact of such volatility on resources used to finance the PRSP and on the income of the poor.

Efficient Allocation of Aid

Coherent and nationally owned poverty reduction strategies should facilitate donor coordination. Aid could become more effective as donors align themselves behind the strategy and provide support for the poverty reduction program at large, rather than financing specific projects under conditions specifically defined by each donor.

In effect, bilateral and multilateral donors to Bolivia, Honduras and Nicaragua have taken a number of steps forward in trying to improve donor coordination and more effective aid provision. However, these positive steps are mainly organizational. Donors are supporting round tables (*mesas sectoriales*) to strengthen dialogue for coordination of the sector programs that are part of the PRSP. In addition, steps have been taken towards more program aid and budget support and the establishment of Joint Financing Agreements among a large group of donors in support of poverty reduction strategies. Nevertheless a good number of round tables do not function well due to lack of political support or organizational capacity on behalf of the recipient government. These round tables have not yet been able to make an impact on aid modalities in practice. That is, they have neither led to any visible improvements in the effectiveness of aid allocation, nor to a stronger sense of ownership among civil society and government. The Honduras round tables have been constructed around the implementation of the PRSP. In Bolivia, there is a round table to coordinate the new consultation process of the National Dialogue and the revised PRSP. It began operations in the second half of 2004. These round tables, with different degrees of success, have opened a space for more dialogue, but not necessarily better coordination, among donors.

This is most obvious in the case of Honduras where most support is still provided for individual projects.

Up to the end of 2004, bilateral donors generally did not offer budget support and only in the Health and Education sectors has there been some movement towards sector-wide support (swaps). In Nicaragua and Bolivia, other sources of coordinated financing can be found in the form of joint financing and more program aid and budget support, although project financing remains predominant. According to a study carried out in Bolivia, the barriers to aid harmonization originate mainly from donors' headquarters which tend to give priority to rapid disbursements and independent evaluation papers produced by each donor, rather than coordinated financing.

The indicated move towards more sector-based program aid and budget support does not seem to have led to much improvement in the sense of ownership for the use of aid funds. Firstly, donors maintain their own budget support conditions and procedures. Secondly, the number of conditions the recipient countries must comply with is enormous. These conditions not only reflect the opinions and priorities of donors – much more than those of the recipient country – but they also involve a whole range of actions and procedures to be undertaken by the recipient government in addition to their regular budget management procedures.

Conditionality related to foreign financing still remains a problem. Original sins prevail. Firstly, an agreement on short-term macroeconomic policies with the IMF remains a precondition for obtaining support from other donors. Secondly, most donors preserve their strong inclination towards 'micromanaging' aid conditionality and monitor a detailed list of policies and reforms that governments should follow. Given the weak governance and credibility of the PRSP countries, this tendency to impose specific policy conditions may seem reasonable in order to ensure program effectiveness. On the other hand, the same donor behaviour tends to erode government commitment and the sense of PRSP ownership among civil society organisations.

Excessive conditionality can be counterproductive. Donors should evaluate whether countries are *implementing a more or less* coherent set of policies for poverty reduction, and not only if they are fulfilling macroeconomic performance criteria. Donors should focus their dialogue essentially on improved budget management in a medium-term expenditure framework. This should also involve support to countries to help them make the move towards more result-oriented budgeting processes. As existing institutional capacity is weak and reformation of budget procedures is cumbersome, a gradual approach on this path would appear desirable.

One of the problems identified in these three countries is the lack of stability in financing within a multi-annual framework. One of the reasons is that IMF financing tends to be pro-cyclical. When the economic outcomes weaken and there are deviations in the adoption of the “correct economic policies”, disbursements are suspended or postponed until certain criteria are met, as in the case of Honduras and Nicaragua. This is due to the fact that there are no clear guidelines of how the IMF should proceed with countries that have governance problems, but that are giving positive signs of implementing policies that favour the poor. Since the IMF is a catalyser of resources, the most immediate impact appears in the HIPC support.

Donors should therefore determine the circumstances under which monitoring should go beyond macroeconomic performance criteria. They should also reconsider the primordial role of the typically short-term macroeconomic agreements with IMF as the catalyser of all other aid flows in support of the PRSP. Furthermore, the PRSPs themselves should be more concrete (not necessarily more comprehensive) in detailing strategies for poverty reduction, indicating how the proposed actions are expected to meet the Millennium Development Goals. In addition, the cost implications of these actions should be properly budgeted. Then, on this basis, a solid commitment may be requested from donors to finance the strategy over the medium and long run. Such ‘result-oriented budgeting’ may help move away from plans that satisfy the requirements of the donors only.

There is also uncertainty on how to proceed with countries that have marginalized the PRSPs from the broader national policy agenda, as happened in Bolivia and Honduras in 2003 and 2004. It appears that sticking to an agreed PRSP is not a requirement for continued financing by donors. Official lending and aid to Bolivia kept flowing despite the fact that the status of the PRSP was in question, even by the country’s own authorities. In 2003, with the aim of reducing the impact of the political crisis that affected the country, the World Bank provided Bolivia with a *Social Safety Net Structural Adjustment Credit* to protect the health, education and social safety net budgets, as well as social services in poor, remote areas. The following year Bolivia received financing through a *Social Sector Programmatic Structural Adjustment Credit* (SSPSAC) in order to support programmes designed to meet the Millennium Development Goals. This flexibility can be beneficial for the country as long as there is accountability in the use of this funding.

In sum, it is evident that the process is still far from meeting initial expectations. These expectations may have been overly ambitious considering the fragile governance of the three countries. In addition, political

turmoil and instability have hindered the process. Bearing this in mind, it would seem advisable to prioritize and focus the PRSP on a more realistic agenda aimed at clear and achievable targets that tackle pro-poor growth more efficiently.

Preface

The Swedish International Development Agency, Sida, has requested the Institute of Social Studies (iss) in The Hague, The Netherlands, to monitor and evaluate the Poverty Reduction Strategy Paper (PRSP) processes in three of the Latin American countries eligible for debt relief: Bolivia, Honduras and Nicaragua. The study will be carried out over a period of 5 years, and began in 2003.²

Each year five reports will be elaborated, including three country reports, one regional (or synthesis) report and a thematic report. The five reports aim to make a contribution to existing evaluations of the PRSP process through the regional focus and an impartial assessment, given that the iss has not taken part in the process of design, implementation and financing of the strategies.

The country reports are supported by a detailed and systematic stakeholder analysis, including the stock taking of local actors through visits to several municipalities in the three countries. A comparative analysis of the experience in the three countries is presented in the regional report, highlighting lessons to be learned by governments, civil society and the donor community. Additionally, a thematic report on a special issue is presented.

The country reports submitted in 2003 provided an in-depth analysis of the PRSP process itself, assessing in particular the processes of consultation and policy dialogue with civil society and to what extent these have laid the basis for a broad-based and effective poverty reduction strategy. The 2003 thematic report referred to a detailed analysis of the decentralization process of budget management and its impact on the poverty reduction strategy.

'Pro-poor growth' is the central theme of the 2004 reports. It was chosen in response to one of the main complaints by several stakeholders in the three countries. Those stakeholders have pointed out that the process of consultation and PRSP design lacked a deep analysis of the relation between the PRSP and economic reforms, so as to assure that the implementation of economic policies be consistent with the poverty reduction objectives. Hence, we asked ourselves how the PRSPs in the three countries define the relation between growth and poverty reduction and whether the proposed policies can effectively promote pro-poor growth.

² iss (2003 a-d, 2004 a, b, d), See also <http://www.iss.nl/prsp> for all evaluation reports.

This 2004 synthesis report concentrates on the potential of national economic development processes to achieve pro-poor growth. It should be emphasized that the PRSP management process is continuous and susceptible to frequent changes. The data collection (particularly the interviews) was carried out between April and July 2004, but the document was not updated until December 2004.

Introduction

The poverty reduction strategy is a response to legitimate concerns about the persistent, extensive poverty prevailing in many developing countries. The Poverty Reduction Strategy Paper (PRSP) approach aims at reducing poverty through a participatory and result-oriented strategy that seeks to meet the needs of each country by bringing together both government and civil society to identify long-term solutions. Donors commit to supporting these strategies with resources and debt relief.

The PRSP framework was introduced in 1999 creating great expectations for the heavily-indebted poor countries (HIPC). It was not only conceptualized as a framework to bring together debt relief, poverty reduction and the achievement of the Millennium Development Goals (MDGs), but it would also provide an opportunity for introducing a participatory process that would tailor the strategy to the country's needs, thereby assuring ownership, national commitment and long term viability. Improved (result-oriented) budgeting procedures would guarantee the transparency and accountability of the policy process. In addition, a country-owned poverty reduction strategy should promote greater coordination among donors as it would enable more effective allocation of development aid.

In their short period of existence, the PRSPs have undergone many changes. This could be a good sign, an indication that a dynamic process of policy formulation is underway. However in fact it has been a source of confusion as, with government changes, new national development plans were produced bearing a less than clear relationship to the original PRSP. Conceived to be comprehensive documents reflecting the relevant set of economic and social policies, second-generation PRSPs have actually been turned into proposals for the restructuring and restoration of the productive sector, giving less priority to social objectives. Such is the case of the revised Bolivian Poverty Reduction Strategy and the National Development Plan proposed in Nicaragua.

The PRSP process faces an uncertain future in these three countries – it is evident that the process is still far from meeting initial expectations. The expectations may have been overly ambitious considering the fragile governance of the three countries concerned. Political turmoil (especially in Bolivia) has hindered the process even more. Bearing this in mind, it would seem advisable to limit and focus the PRSP on a more realistic agenda aimed at clear and achievable targets.

Issues Related to the Dialogue and Main Modifications to the PRSPs

The present 2004 synthesis report focuses on two core aspects of experience with the PRSP approach in Bolivia, Honduras and Nicaragua. First, it addresses the main modifications made to the PRSPs and in the dialogue process since 2003. The following questions are appropriate in all the three cases:

- *Quo vadis PRSPs?* What new directions are these “revised” strategies taking?
- What are the PRSP prospects (and with what agenda) as the axis for economic and social policies?
- Is the participatory process still sustainable?
- Is it possible to reduce the vulnerability of the PRSP consensus to electoral cycles and other changes in national politics?
- Can donor coordination in support of the PRSPs be improved?

Issues Related to ‘Pro-poor Growth’

Second, the report analyses PRSP aspects that are expected to yield higher economic growth *and* to benefit the poor. The guiding issues are:

- (i) to what extent will the PRSPs effectively change the economic growth process to the greater benefit of the poor?
- (ii) How is pro-poor growth conceived?
- (iii) Are the proposed actions feasible and effective?

The idea of ‘pro-poor growth’ has gained momentum within the international debate on development and poverty reduction. Speeding up economic growth will undoubtedly generate more employment and improved incomes, thus contributing to poverty reduction. Nonetheless, what is the most effective way of achieving such growth acceleration? How can we make sure that the poor will be primary beneficiaries of growth and avoid most of the gains trickling down to the non-poor?

The debate on the possible trade-offs between growth and equity is as old as the discipline of development economics. It dates back to at least as early as the well-known Kuznets hypothesis of the 1950s, passing through the debates about “growth with redistribution” of Chenery and others in the 70s, and on to the current debate around the PRSPs. In this sense, it may be rather surprising that there is so little clarity (and consensus) about what should be understood by “pro-poor growth”. Definitions vary between the view that any type of growth that yields improved incomes for the poor is “pro-poor” and that where there is only ‘pro-poor growth’ if the income of the poor increases at a higher rate than that of the non-poor. The latter implies a redistributive type of growth.

If there is no clarity about its definition, asking how to follow a pro-poor growth path is like searching for the ‘Holy Grail’ without knowing what it looks like.³ However, it is not our intention or ambition to settle this theoretical debate here, but rather to identify what prospects the PRSPs offer for altering the pattern of economic growth and contributing to poverty reduction. Our main focus will be placed on evaluating the coherence of proposed actions and, given the structure and political context of the three countries, analyzing whether the selected policies favour growth and poverty reduction and to what extent this kind of strategy has been put into practice (or are priorities still exclusively centered on economic growth?).

³ The reference to the Holy Grail has become proverbial in the current pro-poor growth literature, especially since the influential paper by Stephan Klasen entitled “In Search of the Holy Grail: How to Achieve Pro-Poor Growth” (Klasen 2001).

Status and Progress with the PRSPs and the HIPC Initiative in Bolivia, Honduras and Nicaragua, 2003–2004

1.1 The HIPC and PRSP Framework and the New Aid Modalities

In early 1999 the World Bank introduced the Comprehensive Development Framework (CDF), a long-term strategy for achieving a more integrated and comprehensive development. Within this framework, macroeconomic and financial aspects are linked to social, human and structural aspects, and key stakeholders are defined along with their responsibilities for facilitating the sense of partnership, coordination and accountability.

In December 1999, the World Bank and the International Monetary Fund approved a joint initiative to combat poverty. In this initiative, low-income countries that wish to obtain financing from the international financial organizations or qualify for a debt reduction plan within the framework of the Initiative for Highly Indebted Poor Countries (HIPC) are required to present a strategic plan for poverty reduction (the PRSP). PRSPs are documents written by each country that contain a description of the country's macroeconomic situation, social policies, programs for promoting economic growth and reducing poverty, and an explanation of the financing that would be required to implement the strategy.

Governments that receive foreign aid should become jointly responsible for the results of the programs that are adopted. This would be true for the program's design as well as its implementation. Civil society groups – especially the poor – are expected to define priorities, allowing for greater local support and follow-up.

The International Monetary Fund's Poverty Reduction and Growth Facility (PRGF) is one of the modalities of financial support to the PRSPs, and the approval of the strategy is one of the conditions for receiving PRGF support.

Three general characteristics determine the original link between the PRSP framework and renegotiation of public external debt. First, the operational link between the PRSP and the HIPC Initiative has been designed such that in order to reach an agreement on debt reduction within the HIPC framework, a country must be able to present an Interim-PRSP – a short document containing the diagnostic and poverty reduction policies – while it continues to work on elaborating a full PRSP. Second, the resources obtained through debt relief must be used exclusively for poverty reduction. Third, foreign financing within the PRSP framework should, in a general way, benefit program and sector-wide support rather than project financing. Creditors should coordinate their policies in support of PRSPs, using the PRSP progress reports as a tool to follow up and monitor the efficient use of their resources.

In September 2000, the United Nations made an additional effort to commit the nations of the world to the fight against poverty. UN member countries defined the Millennium Development Goals (MDGs), consisting of 8 objectives, 18 goals, and 48 indicators for the period of 1990–2015. The MDGs are aimed at orienting development policies to create improvements in the following areas: incomes of the poor, education, the situation of women, health, the environment, and donor assistance. The United Nations is responsible to monitor achievements towards these goals. In 2002, the Monterrey Consensus linked the PRSPs to the attainment of MDG goals within a specific time period and broadened the scope for PRSP coordination between government policies and donor support.

The principles of the PRSP approach stipulate that the strategies should be:

- country-driven and –owned, predicated on a process of broad-based participation in the formulation and implementation and in the monitoring of progress toward goals;
- results-oriented, focusing on outcomes that will benefit the poor;
- comprehensive in the diagnosis of poverty, recognizing the multidimensional causes of poverty and measures to combat it;
- partnership-oriented, providing a basis for the active participation and coordination among development agencies involved in supporting the country strategies (PRSPs should

improve the coordination among multilateral and bilateral donors and NGO:s);

- based on a medium and long-term perspective, recognizing that poverty can not be reduced overnight.

The priority public actions of the strategies should include four key areas:

- macroeconomic and structural policies to support a sustainable growth in which the poor participate.
- improvements in governance, including financial management in the public sector and decentralization in policy implementation.
- appropriate sectoral programs and policies.
- realistic costing and appropriate financing levels for the primary program.

According to the PRSP agenda's own objectives, each country should then define its strategy according to its own possibilities and institutional and economic problems and do so based on a national dialogue. It is to be expected, then, that the PRSP content will differ from country to country, both to ensure "national ownership" of the strategy and to provide an adequate response to each country's problems as it guides the process of poverty reduction.

Donors would be expected to respond to this with debt relief under the HIPC terms and, as countries would be submitted to a coherent poverty reduction strategy, they would move away from project-based or specific program based aid towards more general Budget Support for the strategy at large and in a coordinated fashion through Joint Financing Agreements (JFA:s).

Of course after having received debt relief countries could no longer have an incentive to continue the PRSP process. The hope is that with sufficient "country ownership" of the strategy the process would continue and so-called "second generation" PRSPs would emerge along the same principles and provide the programmatic basis for continued coordinated donor support.

Clearly the challenges put forward by the approach are huge and countries have encountered many hurdles as they moved down this path.

1.2 Status of the PRSPs and the HIPC Initiative in Early 2004

Within the HIPC framework, the three countries have advanced at a different pace, see the summary in Table 1 below.

To obtain Budget Support (BS) from all donors and also for the IMF's PRGF, the existence of a poverty reduction strategy is an *ex ante* condition. However, the application of such conditionality has been different among the three countries due to differences in political and economic conditions. (See further chapter 2.) Honduras could only receive BS after February 2004, while Bolivia and Nicaragua obtain it from 2003, after their respective agreements with the IMF of April 2003 and December 2003.

Nicaragua achieved most progress towards meeting the HIPC conditions: it had finalized the fourth PRGF review and achieved the HIPC completion point in the beginning of 2004. What awaits Nicaragua after the HIPC? Is the achievement of this stage enough to attract foreign investment, facilitate growth and avoid falling in the debt cycle again?

Bolivia has had greatest difficulties in subscribing a PRGF because donors have considered that the country no longer had an official poverty reduction strategy. The situation became more uncertain due to the internal social conflicts and delays in complying with donor conditionality. Even so, Bolivia has assigned a higher share of GDP to social spending than the other two countries and many other Latin American countries for that matter.

Honduras formally resumed the PRSP track in 2004 with the approval of the PRGF and the presentation of the first progress report. This substantially increased the resources available for social programs.

1.3 Measuring PRSP Progress in 2003

In 2003, the evaluation focused on a detailed analysis of the different PRSP stages: consultation, design and implementation (see ISS, 2003a). The analysis also addressed the quality of the appraisal of the poverty situation, the coherence between the PRSP policies, the feasibility of the strategy given the economic and political conditions of each country, and the role of donor countries in the process.

The evaluation's main concerns were related to whether the PRSPs have brought any value added to existing poverty reduction policies and whether they would be able to live up to the high expectations created around them. Three issues stand out from the findings of the 2003 evaluation reports: lack of ownership, lack of priorities and lack of complementarity with macro-economics.

Table 1: Status of the PRSPs and the HIPC Initiative in Bolivia, Honduras and Nicaragua as per October 2004

	Bolivia	Honduras	Nicaragua
HIPC A Decision Point	February 2000	July 2000	December 2000
HIPC A Completion Point	June 2001		January 2004
PRSP Approved	June 2001	October 2001	September 2001
PRSP Status	Pending: National Dialogue and 1st PRSP Progress Report	Presented: 1st Progress Report Feb. 2004	Presented: 1st Progress Report Dec. 2002, 2nd report Jan. 2004
Stand-by	April 2003		
Poverty Reduction Growth Facility PRGF	Pending	February 2004	December 2002 4th rev. concluded
<i>HIPC debt relief (1,000,000 USD)</i>			
Original (0)	760		
Extended	1300	900	4500
<i>Poverty reduction expenditure (% GDP)</i>			
2001	12.2	5.4p 3.2e	4.9
2002	12.6	5.9p 2.5e	5.4
		p projected e effective	

Note: Poverty reduction expenditure: note that the above-mentioned percentages are not strictly comparable among the three countries, since each applies a different definition.

Source: IMF and World Bank (2004)

1.3.1 Lack of ownership

The three countries have made significant efforts to undertake national dialogues on the PRSP.

In the case of Bolivia, the dialogue obtained a legal framework through the ‘Law of National Dialogue’, which guaranteed a certain continuity of the process despite the political instability in the country. It has kept the space open for dialogue, however without much success in translating important social demands into the strategy or in assuring increased ownership among national stakeholders. This has led to a persisting view that the PRSP is essentially an invention of the donor community and yet another condition for obtaining debt relief. This

view also predominates in Nicaragua and a somewhat lesser extent in Honduras.

No matter the precise causes underlying this perception, the lack of ownership implies that neither the government nor civil society have true commitment to effectively implement the strategy. This has become evident, among other things, as changes in government led to the elaboration of new development plans which bear no clear relation with the PRSP. Therefore, despite improved national dialogues on poverty reduction, there has not been much success in achieving ownership, which has consequently prevented meeting other objectives of the process.

In other words, as no broad-based support from civil society has been assured for the PRSP policies, also the long-term political viability of the strategy is in doubt and the PRSPs will be highly sensitive to each government change and electoral cycle.

1.3.2 Lacking clear priorities

In essence, the PRSPs do take a comprehensive approach towards poverty reduction. However, in practice the designed policies have lacked a clear priority setting in actions, leading us to the conclusion that the PRSPs “do not represent strategies as such”, but rather a list of good intentions. This lack of priorities weakens the capacity to adapt poverty reduction policies to changes in the economy and increased budget constraints. The PRSPs are also weak in connecting actions to budget allocations and expected outcomes. This slow progress towards more result-oriented budgeting is hampering the transparency and accountability in the use of funds for the PRSPs as well as the monitoring of the impact of fiscal policies on poverty reduction.

1.3.3 Lacking complementarity with macro-economic policy

Considering that a comprehensive poverty reduction strategy should be accompanied by a coherent mid-term macroeconomic scenario, this complementarity has been considerably weak, which has generated at least three problems for the PRSP implementation process:

- (i) The non-inclusion of macroeconomic policy in the PRSP dialogue agenda, an item important to several major stakeholders, has put aside some key civil society actors and weakened the sense of national ownership.
- (ii) This has also nourished the perception that access to foreign aid and debt relief is still subject to the traditional IMF conditionalities.

- (iii) The PRSPs aim at spurring economic growth, but fail to specify how aggregate growth of output will lead to the targeted degree of poverty reduction. In actual policy practice, the PRSP implementation has mainly emphasized budget reallocations towards social expenditures. In this sense and given the HIPC context, some see that in practice the PRSPs have turned out to be a mere “debt-for-social expenditure swap”.

In the case of those three countries, evidence shows that some “original sins” in the design of the PRSPs have somehow tainted their future. The limited time devoted to the design of the strategy, the deficiencies in the cost estimations for the process, the weak identification of the transmission channels between proposed actions, implementation mechanisms and expected outcomes, and the absence of dialogue regarding a number of politically sensitive issues have all contributed to the limited sense of ownership and actual participation in the strategy.

It should also be considered that donor conditionality has expanded into other spheres beyond the traditional macroeconomic indicators, thereby reducing the effectiveness of the partnership between certain donors and recipient countries. There has been increasing tension in defining priorities and marked inflexibility in the implementation of certain conditionalities among the different economic sectors. Thus, again, the country ownership of the PRSP is in question, as are the strategy’s chances of political survival during electoral cycles.

1.4 Progress towards PRSP Objectives

Table 2 presents a summary of the progress made in the PRSP process in the three countries in 2003 and 2004 concerning the basic principles established for the development of poverty reduction strategies, that is, ownership, participation, partnership, results-orientation and sustainability. Common points as to issues in the national politics and economic sphere are discussed below.

Table 2: Progress towards PRSP objectives in Bolivia, Honduras and Nicaragua in 2003 and 2004

	Until 2003	Until 2004
Ownership*	<p>Low government ownership in the three countries. Even in cases such as Nicaragua, it is said that consultants were paid with donor resources to design the PRSP. The dichotomy between the processes of consultation and design, that is, the lack of feedback between the two led to considerable frustration among some civil society actors.</p>	<p>In Bolivia, no strategy exists which has been accepted by the country and some civil society organizations are even not aware of the PRSP. Key actors in the government consider the PRSP to be "dead". In Nicaragua the government is committed to a new National Development Plan, which does not bear a clear link to the PRSP. The government of Honduras has shown stronger commitment towards the adjusted PRSP. In the case of Honduras and Nicaragua, there is apparently an agreement between the government and donor countries to support new proposals. In none of the three countries ownership has increased among civil society actors. In fact, the sense of ownership is seen to have weakened.</p>
Participation	<p>In Bolivia there was grassroots participation and in theory the role of some actors (municipalities) was strengthened. In Honduras and Nicaragua the consultation was markedly top-down. In those countries the under-representation of the poor was one of the handicaps of the process. In the three countries the PRSP civil society participation gradually weakened. For instance, the macroeconomic framework of the PRSPs was not put under discussion.</p>	<p>Participation in Bolivia continued to be based on the National Dialogue. In September 2003, the third National Dialogue was launched, but by the end of 2004 results have not materialized yet. In Honduras and Nicaragua broad-based participation has not advanced. In Nicaragua there were consultations for the National Development Plan at the level of provinces (departamentos), which included different actors compared to those involved in the consultations for the original PRSP. However, again there has been no follow-up to these new consultations when designing the PND.</p>

	Until 2003	Until 2004
Partnership	The partnership with the international community is framed by the commitments derived from the aid conditionality, which has broadened under the PRSPs. Donor coordination has made the monitoring and evaluation easier, but there is no increased sense of local ownership over the use of donor funds. Internally, public-private partnerships are still weak.	In Honduras, Bolivia and Nicaragua the government commitment is associated with and still limited by aid conditionality. In Bolivia and Nicaragua the domestic support for the national government has declined. In 2004, Honduras seems to have reached greater consensus about PRSP implementation at least within Parliament.
Results based	Weak. Strategies are mostly still at the level of being proposals and have not reached actual implementation. There has been progress in terms of developing indicator systems for PRSP monitoring and the MDG:s are being used as the main target variables of the strategy. Results-oriented budgeting (ROB) would be useful to evaluate impact, but in practice the PRSPs have no clear specific links between actions, budgets and expected impacts.	Little progress. The PRSPs are still at the level of proposals with no priority setting for result based implementation. The MDG:s have been turned into parallel monitoring variables. Slow progress in achieving greater transparency in the budgeting process and certainly no progress in ROB. There is no connection between operational plans and the intended policies.

cont. →

	Until 2003	Until 2004
Sustain-ability	<p>In the three cases the basis of support corresponds to existing processes (the National Dialogue Law in Bolivia, the Hurricane Mitch Consultation Mechanism in Honduras, and institutions created for this end in Nicaragua, such as CONADES and CONPES. However, all 3 cases are threatened by political instability. The status of the PRSPs is vulnerable to changes in the government, hence limiting the practice of a long-term view.</p>	<p>In Bolivia, the PRSP did not survive the change in the government. The National Dialogue was postponed for a year. In Honduras and Nicaragua the national dialogues have not gone further. Parallel plans have been designed, but they contain the approach of the national development agendas. In Bolivia and Nicaragua, the connection between those Development Plans and the PRSPs is not evident and important stakeholders have come to question the legitimacy of the PRSP. The main challenges are overcoming severe deficiencies in the institutional capacity for implementation (costing, budgeting) and finding ways to bring sensitive reform issues back on the agenda. The financial viability of the strategies is also in jeopardy as economic growth rates did not meet the targets set in the strategy.</p>

Notes: * According to the PRSP Source Book (World Bank 2002) ownership means the inclusion of the opinion and feedback of the stakeholders by creating public debates during the PRSP design and implementation.

Source: ISS (2003b, c, and d) and ISS (2004a, b, and c)

1.5 Common Critical Spheres

Comparing the three cases, the following common points can be identified:

1.5.1 Weak attention to participation and gender

The conclusion is that broad-based participation has not lived up to expectations. In fact, civil society has lost space *vis-à-vis* the new agendas of the second generation PRSPs. Attention for cross-cutting issues such as gender, has weakened even further (see Box 1).

Box 1: Gender aspects have lost ground

The 2003 evaluation reports mentioned that gender was the cross-cutting topic that required more reinforcement in the PRSPs. In 2004 pro-gender initiatives have materialized with different levels of progress. On balance, we must conclude though that gender aspects have lost ground in the content of the reviewed PRSPs. The National Development Plan of Nicaragua lacks analysis and specific pro-gender policies. In Honduras, greater women participation in the 'mesas sectoriales' (roundtables) has been proposed. However, in practice representation of women's organizations has been irregular except for the Roundtable on Security and Justice. The *First PRSP Progress Report of Honduras* (December 2003) indicates that the interviewees have asked for greater emphasis on topics such as gender, childhood and ethnic minorities. They have also requested that these issues be included in government policies. There was some progress in terms of information gathering, as more gender-specific data were included in the population census and household surveys so as to better determine the economic contributions of women. At difference from the 2000 Dialogue, the 2004 Dialogue in Bolivia has not requested active women participation in the roundtables. However, the moderators, facilitators and organizers have been trained in gender equity concepts in order to apply them in the roundtable discussions. One of problems is that gender issues have been only included as part of the broader strategy considerations, but these have not been translated into specific policies.

In sum, the gender focus of the PRSPs remains weak. Where there are gender-specific policy proposals these suffer from the same weakness as the overall strategy, that is a weak and unclear link between proposed interventions, budgets and expected outcomes. This will also hamper the monitoring of the impact of the actions that eventually are implemented.

Source: ISS (2004 a, b and c).

1.5.2 Hindrances in national politics

National politics have been one of the most important hindrances in defining the viability of the strategies and of their reforms. Bolivia's political woes have led to a temporary suspension of the PRSP. Political tensions in Nicaragua are creating worries about the continuity of the process. In Honduras, where PRSP implementation was initiated with some delay, the process is also facing greater uncertainty due to the upcoming presidential elections. This uncertainty has emerged despite the fact that the present government is more strongly committed to the PRSP after obtaining a Poverty Reduction Growth Facility (PRGF)⁴ and having produced its first PRSP progress report at the end of 2003.

⁴ IMFS Poverty Reduction Growth Facility (PRGF) – once approved – triggers funding by other donors, but continues to emphasize short-term macroeconomic targets without sufficient consideration of the longer time span needed to effectuate the necessary investments and structural changes for ambitious growth and poverty reduction agenda.

1.5.3 Weakening factors in the economic sphere

In the *economic* sphere, the main weakening factors for the PRSPs are: certain recurring problems in the design process, such as the lack of compatibility between the PRSP and the PRGF; the protagonist role assigned to the private sector without taking into account the actual time needed acquire the sector's participation; and the absence of an analysis of the trade-offs involved in certain policies. Even though Honduras has approved a PRGF, there is no specific pro-poor agenda beyond the general objectives of reducing poverty by means of macroeconomic policies. Growth targets of the revised PRSP and the PRGF are compatible. However, the question is not one of consistency between growth figures, but rather to what extent macro policies are consistent with a long-term strategy of pro-poor policies and with a budgeting process favouring pro-poor expenditures. The strategies have little to say about the latter type of consistency.

As to private sector involvement, the strategies in the three countries have not taken into consideration that economies with weak financial structures, limited access to foreign capital and political instability tend to slow down private investment and thus economic growth. At the same time, progress reports do not assess the distributive impact of important economic reforms, nor its implications for the PRSP process. Furthermore, evaluation mechanisms such as social impact analysis are still no formal component of the progress reports.⁵

1.6 The PRSP Progress in 2003–2004 and Future Prospects

1.6.1 Large risks

The *risks* facing the continuity of the PRSP process seem far larger than the achievements so far. The underlying risks are associated with weak financial systems, heavy public debt, fiscal fragility, corruption, and the way both decentralization and pension fund reforms have been implemented. Certain country-specific issues provide additional risks, such as the reform of natural gas production and exports in Bolivia, the negative impact of the rise in oil prices on the Honduran and Nicaraguan economies, and the high dollar-denominated domestic public debt overhang in Nicaragua.

Country-specific political and economic circumstances have led to differential treatment by the Bretton Woods institutions. On the one hand, there has been flexibility in terms of conditions and aid disbursements at cost of less transparency in the rules of providing aid and loans. The re-

⁵ It is known that Nicaragua has launched studies in the cases of tax and education reforms and an evaluation of the impact of the tax reform was done in Honduras, concluding that it is slightly progressive in distributive terms.

Table 3: The PRSP progress in 2003–2004 and future prospects

	Bolivia	Honduras	Nicaragua
PRSP progress 2003–2004	<p>The PRSP did not reach its objectives, although the contribution to dialogue was important. The Consultative Group (<i>Grupo Consultivo</i>) did not accept the revised PRSP, mainly because it had not been the result of a participatory process involving the population. The IMF extended the Stand-by agreement. International support has been sustained despite the uncertainty around the PRSP.</p> <p><i>Sensitive topics:</i> limited attention to political processes, reduced ownership by Congress, and reform of the “Hydrocarbons Law” (Ley de Hidrocarburos).</p>	<p>Greater progress was achieved in: institutional aspects of the strategy, budgeting management and legislation, civil society participation in Consultative Council (CC), commitments regarding improved donor coordination, and a PRGF agreement with the IMF.</p> <p><i>Sensitive topics:</i> no progress in achieving broad-based participation; problems with making the poverty reduction policies operational.</p>	<p>The PRSP has become less participatory and important with the establishment of the new strategy. There were no comprehensive efforts for poverty reduction.</p> <p>The international support was sustained. In general there have been moves towards enhanced donor coordination, but there are still problems of donor coordination at the operational level.</p> <p><i>Sensitive topics:</i> despite the “territorial” consultations for the National Development Plan, neither the dialogue nor broad-based participation has been enlarged. Municipal authorities do not take any ownership of the PRSP or PND.</p>
Prospects	<p>A revised PRSP was proposed. There is no firm proposal yet. The process of National Dialogue has advanced, but with no concrete results. Bolivia faces political and social challenges.</p>	<p>Changes in the PRSP were proposed with the Action Plan of the Poverty Reduction Strategy (2004).</p> <p>The 2005 elections pose a challenge to the policies agreed under the PRSP.</p>	<p>Changes in the poverty reduction strategy. The National Development Plan (PND) presented in January 2004 has attempted to make room for a new ‘Reinforced Strategy for Economic Growth and Poverty Reduction’ (ERCERP II), but until now it has counted with little participation. Nicaragua faces political challenges due to the existing tension between the government and party interests.</p>

Source: ISS (2004a, b, and c)

sponses of the IMF, the World Bank and donors to modified PRSPs equally have been different between the three countries (see chapter 2).

In principle, the redesign of the second generation PRSPs which are not linked to HIPC resources, should allow governments to imprint their own identities on the strategies. The new plans enjoy greater ownership by the governments (Honduras and Nicaragua) that developed these. This could lead to a diversion from some of the initial PRSP objectives, but increase the sense of ownership. It still remains to be seen though whether these changes will make the strategies more feasible from the country's perspective, but the prospects of that are somewhat bleak in the light of the above risk assessment.

Donor Coordination and the Allocation of Aid

CHAPTER 2

As indicated in chapter 1, the three countries have advanced at a different pace. The following question emerges: how effective have donors been in supporting the Poverty Reduction Strategies in Bolivia, Honduras and Nicaragua? The initial expectations were that the PRSP process would lead to better donor coordination in support of a common program, i.e. the Poverty Reduction Strategy. It was thus expected that the existence of a PRSP would lead to a shift in aid modalities towards program support. The share of budget and sector-wide support would increase in total aid flows. In principle, such a move could lead to a reduction in the transaction costs associated with foreign aid and in the cross-conditionality.

2.1 The Round-table Discussions

In 2003, the governments of the three countries established roundtables (*mesas sectoriales*) for donor coordination in the different sectors. In Honduras and Nicaragua this process started at the beginning of the year. In Bolivia the new government reestablished roundtables for coordination in five areas after October. The new roundtables also address political issues such as the Constitutional Assembly, the Referendum and the National Dialogue. Hence they are not only focused on aid coordination for a specific sector, as previously done and as in the case of Honduras and Nicaragua. Two governmental representatives and two donor representatives, excluding civil society, coordinate them. In Nicaragua and Honduras, in principle one of the civil society representatives takes part in the roundtables (in Honduras due to the Poverty Reduction Fund Law, FRP), but it has been questioned if these participants are actually representative for key sectors of civil society.

In Nicaragua civil society is not present in all roundtables. Donors have decided that the roundtables would replace the former donor coor-

dination platform, i.e. the *Good Governance Group* (GGG), with the exception of the “Global Donor Roundtable”, where ambassadors and directors of international agencies meet several times per year. Honduras has kept the G-17 donor group operational. It includes bilateral and multilateral donors. The roundtables in Nicaragua are not linked to the PRSPs, whereas in Honduras it involves the same representatives that also take part in the Consultative Council as regulated by the FRP Law.

However, in Honduras donors have kept their own forum for coordination, outside the government. The general view is that the roundtables “do not work”. A major complaint is that there is no adequate tripartite monitoring process of the activities and expenditures of the PRSP. High-level representatives lack interest and there are organizational problems.

In Bolivia and Nicaragua, where the roundtables are jointly coordinated by donors and the government, some appear to work better than others, depending on the government’s interest on the topic or sector and on its capacity to take leadership in the coordination.

2.2 Lack of Coordination/Cross-conditionality

Even though there are mechanisms for coordination and communication in the three countries, this has not led to better coordination at the operational level. This is especially manifest in Honduras, where almost the totality of aid is assigned to individual projects. Bilateral aid in general does not support the budget and only in education and health some progress has been made towards swaps. In the other countries there are some examples of joint financing (*canastas*) and budget support (BS). But even there, the greater proportion of aid comes in the form of individual project support, often accompanied by the establishment of executing units for which new staff is hired and given higher salaries than public employees.

According to a study carried out in Bolivia, the obstacles to harmonization originate from donor headquarters, which give incentives to rapid disbursements and prefer elaborating their own aid strategy documents rather than coordinating these efforts (“Nordics +” donors 2004).

2.2.1 The Joint Financing Agreements – positive change

Some positive change have come with the *Joint Financing Agreements – JFA* (see further Table 4 below), which would potentially promote the reduction in cross-conditionalities and improve donor coordination. There are some recent initiatives within the PRSP framework in Bolivia and Nicaragua that are still to be implemented. In Honduras JFA:s had not been elaborated as yet in 2004.

2.3 Budget Support

As mentioned above, an agreement with the International Monetary Fund (IMF) continues to be the primary condition for BS, for bilateral and multilateral donors alike. Consequently, Honduras could only receive BS after February 2004, while Bolivia and Nicaragua could already receive it (again) in 2003, after their agreements with the IMF signed in April 2003 and December 2003, respectively.

All three countries received BS in 2004, as they had an on-going agreement with the IMF.

However, this does not necessarily imply that this has improved aid efficiency and effectiveness and even less so that it has improved aid ownership by the government. First, donors have different BS systems, with their own conditions and procedures. Second, the number of conditionalities is very high, as expressed in Table 4.⁶ The conditions do not only reflect donor opinions and priorities rather than those of the recipient country, but in many cases they also refer to detailed descriptions of interventions and procedures to be undertaken by the recipient government. That is, the donors heavily engage in micro-management.

2.3.1 Conditionalities of World Bank credits

The World Bank and the Inter-American Development Bank (IDB) have given policy-based loans to all three countries. This is a kind of budget support (the money is freely used, being allocated to the Ministry of Finance) with conditions for policy reforms in other sectors.

For lack of a recognized PRSP, Bolivia obtained a *Social Sector Programmatic Structural Adjustment Credit* (SSPSAC) from the World Bank. The SSPSAC includes conditions for policies in health, education, water and sanitation, and social protection, as well as to social indicator systems for monitoring and evaluation. Honduras and Nicaragua did receive the World Bank's instrument in support of the PRSP process, i.e. a *Poverty Reduction Support Credit* (PRSC). The PRSC for these countries comprises conditions for other public reforms as well. For instance, in the area of governance, it involves reforms to budget management and administrative decentralization. Con-

⁶ The Table gives an example concerning World Bank loans. It should be mentioned that the sum of "conditionalities" is not weighted for the type of condition, which can constitute both administrative actions and conditionalities in terms of the kind of policy that is to be implemented. Since we are talking about agreements and contracts between the government and the multilateral bank or bilateral donors, such conditions by definition have the acquiescence by the government. The point here is that there are many requirements to be fulfilled, which in part do not match the existing procedures for the accountability of public expenditure. In such case they end up increasing transaction costs involved in the management of resources. We have made no effort to quantify these costs, but the total number of requirements suggests that they could be substantial.

ditions are also set for promoting growth by means of improving the environment for private investments and access to infrastructure (through the privatization of energy, water and telecommunications). For each sector, several requirements have been defined concerning government policies, as well as indicators related to their effects or impact.

The policy matrix of the different loan documents specifies conditions for each disbursement. The sum of all these conditions is huge (see Table 4 and footnote 6). However, more important than the number of conditions are the policies behind the conditionality. With the PRSP it was expected that support would be given to the program as a whole through BS, with no need to add conditions on specific policies in the loan contracts.

Table 4: Number of conditionalities of World Bank credits that support PRSPs***

Country	Condition- alities first year	Condi- tionalities second year*	Condition- alities third year**	Total	Indicators of impact or effect
Bolivia					
SSPSAC	45	41	29	115	27
Honduras					
PRSC	76	80	57	213	56
Nicaragua					
PRSC	37	62	42	141	56

Notes: * For Nicaragua, this refers to the second path of the PRSC-I; for the other countries it refers to the PRSC/SSPSAC-II.

** For Nicaragua this corresponds to the PRSC-II, for the other countries it refers to the PRSC/SSPSAC-III.

*** See also footnote 6.

Sources: Policy matrices aggregated to the PRSC and SSPSAC loan documents, obtained from www.worldbank.org.

2.3.2 Differing views among donors

In general, *there is a compromise among donors towards allocating more aid to budget support (BS)*. Some donors have defended BS for many years (Denmark, Norway, The Netherlands, the UK, Sweden, Switzerland), others have recently moved in this direction (Germany, Finland, Ireland and the European Union), and others are still considering it as a possibility or applying it only to exceptional cases (Belgium, Canada, Japan). Countries of Southern Europe and the US keep providing exclusively project aid, although this sometimes includes (such as in Bolivia) the payment of debt

service to international financial institutions, which in practice means budget support.

Therefore, the incidence and amount involved in BS in a recipient country depend to a large extent on which group of donors is active in the country. In the three countries of this study, project donors such as Canada, Spain, Japan and the US are relatively strong. In Bolivia and Nicaragua there is also a relatively strong group of donors that are more familiar with BS. In Honduras, for a long time Sweden was the only donor interested in BS, which explains the low level of BS. Recently, the European Union and Germany (by means of the aid agency KfW) have also indicated interest to provide BS to Honduras.

As stated above, an agreement with the International Monetary Fund (IMF) continues to be the primary condition for BS, for bilateral and multilateral donors alike. Consequently, Honduras could only receive BS after February 2004, while Bolivia and Nicaragua could already receive it (again) in 2003, after their agreements with the IMF signed in April 2003 and December 2003, respectively.

2.3.3 Different application of conditionality

To obtain BS from all donors and also for the IMF “Poverty Reduction and Growth Facility” (PRGF), the existence of a poverty reduction strategy is an *ex ante* condition. However, the application of such conditionality has been different among the three countries due to differences in political and economic conditions.

As we have mentioned in the 2003 Regional Report (ISS 2003a), the IMF did not sign a PRGF with Bolivia, but only a Stand-by. Honduras and Nicaragua did manage to obtain a PRGF. As indicated, the World Bank followed suit by providing a PRSC to Honduras and Nicaragua, while Bolivia could only obtain a SSPSAC. The argument was that Bolivia did not have an official poverty reduction strategy in place. The Consultative Group (annual meetings with all donors and government representatives) also stressed that Bolivia should follow a participatory process of consultation as part of the approval of the revised PRSP. The achievement of agreements with donors became more uncertain due to the impossibility of reaching a political agreement on the distribution of revenues from natural gas exploitation. In addition, the country was off-track in terms of its fiscal targets.

This difference in applying conditionality stems from a different appraisals of the situation in Bolivia and Nicaragua: the actions taken to put the highest officials of the former government on trial for corruption gave a fair amount of credibility to the current Nicaraguan government

and it could subsequently count on a greater flexibility by donors. In contrast, the political instability in Bolivia generated greater uncertainty and a tougher stance by donors on insisting on certain conditionalities related to the PRSP. Nonetheless, in April 2003 the IMF felt pressed to establish a new agreement with Bolivia to support political stability. Other donors followed by giving BS (without conditionalities) to finance the fiscal deficit, even though they manifested that the conditions for budget support were not present. They feared that in not doing so the country would destabilize even more.

Consequently, the dissatisfaction of the IMF and the other donors focused on taking a tougher position regarding the other conditions, particularly the requirement that there should be a PRSP and that it be designed in a participatory way. However, paradoxically, despite the little progress in the consultation process, aid monies have kept flowing, thereby weakening in practice the importance of the PRSP in actual policy making.

2.3.4 Bilateral conditionality beyond usual conditions

Bilateral donors impose other forms of conditionality which go beyond the usual conditions when they provide BS. Such conditions relate to governance, particularly in the area of budget management and accountability⁷ and the fight against corruption. But in this area it is more difficult to define minimum requirements. Each donor sets its own priorities and thresholds. If the main support for BS comes from donor headquarters, then it appears that donors are willing to accept lower levels performance in terms of good governance.

During 2004, a large group of donors in Bolivia and Nicaragua expressed that the conditions for BS were present (hoping that both countries will design a PRSP II), despite the limited progress achieved in improving budget management. In Nicaragua, donors apparently trusted the Bolaños administration, mainly because he has chased corruption by the preceding Alemán government. In Bolivia, donors supported the Meza administration because they feared that political instability would possibly result in his downfall. In both cases, the evaluation of “governance” levels is context-specific and highly subjective.

2.3.5 Donors’ tools for off-track situations questioned

The donor institutions, also responsible for monitoring and follow-up, often fail to assess and discuss the reasons for the delays in complying with the conditionality. In contrast, donors permanently bring up the issue of

⁷ For instance, they require the establishment of a Medium-Term Expenditure Framework, MTEF.

risks, for instance in the evaluation reports, Joint Staff Assessment Reports, jointly presented by the World Bank and the IMF. Their involvement has been limited to this level and has not been very constructive in dealing with situations when a country is off-track. The Independent Evaluation Office at the IMF⁸ which monitors the PRSP process has been critical of the Joint Staff assessment reports as a tool for decision-making and for understanding the changing financing gaps when program implementation is delayed.⁹

2.4 Conclusions: Donor Coordination in the PRSPs

The most important aspects are:

2.4.1 Roundtables lack efficiency

In the three countries, the respective governments have taken initiatives towards improved donor coordination (re)establishing the roundtables. However, most of the roundtables do not function well, which is generally due to the lack of political will or lack of capacity of the recipient government. On the other hand, those attempts towards better coordination have not done much to reduce the vast differences in operational procedures applied by the various donors. As a result, the roundtables have neither brought greater aid efficiency nor greater ownership by the government. In Honduras there is a connection between the roundtables for donor coordination and the PRSP, but the roundtables do not function satisfactorily as for a to lay the ground for implementation of programs and policies. In Bolivia, there is a roundtable to steer the Dialogue for the consultations which should lead to a revised PRSP.

2.4.2 Lack of priority setting

The PRSPs lack priority setting. As a result, all donors tend to set their own targets in their BS programs.

2.4.3 Subjective application of new forms of conditionality

An agreement with the IMF has proved to be the most important *a priori* condition for providing budget support. This means nothing has changed with respect to the 1980s and 1990s, that is, before the PRSP process. In addition, bilateral donors (and the European Union) have introduced

⁸ IMF (2004) Report on the Evaluation of the PRSP and PRGF.

⁹ In ISS (2003a) this problem was mentioned when of the evaluation of the PRSP implementation and feasibility, mentioning that optimism about the growth targets was kept without the undertaking of corrective measures.

conditions concerning governance, particularly in the field of budget management. However, in practice the application of these new forms of conditionality has been very subjective and context-specific. If donors trust a certain administration (or, to be more precise, if they trust it more than they trusted the previous administration, despite the prevailing weak governance) or if they fear that the retention of aid could affect the political stability, governance criteria are put in second place.

An increasing amount of donors has moved towards budget support (BS), but this move mainly comes from policies induced at the donor headquarters and does not bear much connection with the PRSPs. Consequently, having a PRSP is not a sufficient condition for obtaining budget support. However, in some cases, such as the support of the IMF and World Bank to Bolivia, the “existence of a PRSP” has proved to be a necessary condition to obtain BS under the most favourable conditions.

So far the movement towards BS has led to a number of different systems and procedures and to an increase in the number of policies and targets to be complied with. Consequently, the process has not reduced transaction costs for both donors and the recipient country. In Bolivia and Nicaragua there have been harmonization attempts by means of Joint Financing Agreements, but these have not been implemented yet. Therefore, it remains to be seen whether these common systems will replace individual aid programs and effectively reduce cross-conditionality or not.

2.4.4 The heavy policy conditionality is counterproductive

The large number of conditions attached to BS, particularly to World Bank loans and – to a lesser extent – to IDB loans, reduces the positive effect of BS. In fact, it may even have a negative effect. Donors state that the conditionalities and targets originate from the PRSP and thus that these are conditions and targets defined by the country itself. However, it is not perceived this way by stakeholders of the recipient countries. First, as also emphasized in the 2003 evaluations (ISS 2003a), the PRSPs are documents owned more by donors than by the recipient countries themselves.

Donors tend to see conditionality as a mechanism through which aid will drive governments to adopt the “right policies”. However, paradoxically, the heavy policy conditionality is a reflection of the mistrust on the side of the donors that governments are sufficiently committed to policy reform. This mistrust undermines the spirit of development cooperation. As many studies have shown in different other contexts as well, heavier conditionality does not guarantee the adoption of the “right policies” (see among others Collier et al. 1997; Dollar and Svensson 1998; Killick et al. 1998; World Bank 1998; Dijkstra 2002).

2.5 Summary of Progress Achieved in the Donor Coordination

Table 5 summarizes the progress achieved in donor coordination in the context of the PRSPs.

Table 5: Progress achieved in donor coordination

	Coordination Roundtables	Monitoring and Follow-up	Funding for Budget Support*
Bolivia	Five roundtables in operation with mixed results	Progress in developing proposals for monitoring systems, but not much progress in making these operational.	The IMF is catalyst for other donors. A PRSP and a PRGF are needed for BS. The World Bank (SSPSAC) and the IDB provide budget support. Coordination among bilateral donors has improved with JFAs.
Honduras	Donors still keep their own coordination platform, outside the government. Most roundtables do not work.	Progress in developing proposals for monitoring systems, but not much progress in making these operational.	The IMF is catalyst for other donors. A PRSP and a PRGF are needed for BS. The World Bank (PRSC) and the IDB provide budget support.
Nicaragua	Donors have decided that the roundtables would replace the former group for donor coordination, the Good Governance Group (GGG), with the exception of the “Global Donor Roundtable”, where ambassadors and directors of international agencies meet. Most of the roundtables do not function well and are apparently not connected to the PRSP.	Progress in developing proposals for monitoring systems, but not much progress in making these operational.	The IMF is catalyst for other donors. A PRSP and a PRGF are needed for BS. The World Bank (SSPSAC) and the IDB provide budget support. Coordination among bilateral donors has improved with JFAs.

Notes: * Currently there are existing credit facilities of the World Bank: PRSC Poverty Reduction Support Credits to support public sector performance and the governance of countries with a PRGF and STATCAP. In the case of Bolivia the World Bank has opted for providing a *Social Sector Programmatic Structural Adjustment Credit* (SSPSAC). Some donors overtly support BS (like Sweden) and others are moving in this direction (such as the EU, which already gives BS to Nicaragua and Honduras).

Pro-Poor Growth: A Dark and Rocky Road

CHAPTER 3

3.1 No Consensus

Poverty reduction strategies are at the top of the international development agenda and knowledge has increased about the determinants of poverty. Yet we know rather little about the effectiveness of policies to reduce poverty in practice. Good practices of pro-poor policies are not easily established as universal reference points, given widely differing initial poverty conditions and institutional settings across countries. This clearly complicates the task of the evaluator in determining the effectiveness of pro-poor growth policies. This report does not intend to propose a blueprint or a specific pro-poor growth strategy for Bolivia, Honduras or Nicaragua. Rather, it simply assesses the choices made by the three countries in their quest towards this objective.

There is no consensus among academics or national policy makers about what should be the contours of a pro-poor growth strategy. The international donor community has sponsored studies in order to understand the relationship between growth and poverty reduction and – apart from putting the issue of pro-poor growth on the aid agenda – it has gradually changed its approach to pro-poor policies. The inclusion of safety nets in IMF Programs, debt alleviation in the HIPC context tied to poverty reduction, new financing modalities such as the Poverty Reduction Growth Facility (PRGF) and the PRSP framework and the links to the Millennium Development Goals are some examples to this end.

Donors agree that the link between growth and poverty reduction requires more in-depth study. A recent report from the IMF which evaluates PRSP experiences puts it as follows: “...it is worth emphasizing at the outset that knowledge of the links between policies and growth remains limited and understanding of the links between policies and poverty reduction even less so.” (IMF 2004)

This implies that quite a bit of experimenting with what policies work and which not seem unavoidable. It also implies that ‘one-size-fits-all’ approaches or policy solutions based on cross-country experiences simply will not do. The strategies will need to consider the country-specific institutional and structural characteristics as a starting point.

3.2 Two Major Definitions

In the search for the ‘holy grail’ it is sometimes forgotten that we may disagree as to what the ‘holy grail’ actually is. In this sense, also the literature on pro-poor growth has not reached consensus around one single definition of the concept. Two definitions dominate the discussion.¹⁰

- The first concept speaks of pro-poor growth when the income of the poor increases at a higher rate than that of the non-poor. That is, when inequality reduces. It occurs when redistributive changes following from growth favour the poor and there is greater poverty reduction than if all incomes had increased at the same rate (Klasen 2004; Kakwani and Pernia, 2000; McCulloch and Baulch, 1999).
- The second states that the poor should benefit in absolute terms, therefore depending only on the rate of change of poverty. The objective of a pro-poor growth strategy then would be to reach an economic growth path producing a maximum of poverty reduction. Therefore, both growth and income redistribution are important (Ravallion and Chen, 2003; Kraay, 2003).

3.2.1 Redistribution of incomes

The first definition emphasises the need for a redistribution of incomes. According to Ravallion (2004) the problem of the first definition is that even though there may be great efforts to improve the conditions of the poor, growth may benefit the rich more than the poor. In that case, the overall impact of policies would be characterized as “pro-rich” even though absolute poverty would decline strongly. For this reason he proposes the second definition, which exclusively focuses on what happens to the poor.

¹⁰ The formulation of such definitions has been extracted from Ravallion (2004).

3.2.2 Growth for maximum poverty reduction

The second definition is more concerned with poverty reduction per se, thereby closer in concept to the targets of the PRSP and the Millennium Development Goals. It also simplifies the analysis by centring the impact of policies exclusively on the poor. This does not imply that the second approach need not have any concern with redistributive policies. Yielding a growth process enabling “maximum poverty reduction” in most contexts will require a strong emphasis on redistribution of wealth and incomes. This holds most in particular for the Latin American countries characterised by high levels of initial income inequality, implying that little of the growth benefits tend to trickle down to the poor. For the purpose of this study we will concentrate on this second definition.

Nonetheless, we should realize that the second definition requires defining what kind of growth would generate “the greatest poverty reduction”. There is consensus around the idea that countries that have gone through long processes of growth tend to have lower poverty rates. Also countries with lower initial inequality in income distribution tend to have a higher “growth-poverty elasticity”. In other words, each percent of economic growth in those countries leads to greater poverty reduction than in other countries with higher inequality. Therefore, redistributive policies would allow a kind of growth that is more pro-poor. However, there is no consensus about whether more equality would support higher growth or actually limit it. The possible trade-off between growth and equity is part of an old and longstanding debate about development strategies in general. More equity can lead to higher growth among other things because it would bring about increased access to health and education, thus generating higher productivity levels. On the other hand, if for instance a redistributive policy implies generating a non-sustainable and inflationary fiscal deficit, growth can be negatively affected due to the increased instability and uncertainty in the economy.

3.3 The Four Main Axes of Poverty Reduction Policies

How has the concept of pro-poor growth been incorporated in the PRSP framework? The PRSP Source Book mentions that economic growth is a necessary but not sufficient condition for poverty reduction, since its impact on the poor depends on how it is distributed across the population (World Bank, 2002). It also points out that the essential factors that determine such impact are given by the structure of the economy (e.g. a predominance of the agricultural sector or of labour-intensive sectors) and by mechanisms that redistribute the benefits of growth.

The PRSP conceptual framework is based on a multidimensional definition of poverty. It goes beyond the money-metric approach. Due to this conceptualization, the PRSPs typically propose to develop poverty reduction policies in four main axes.

- a. Increase economic *opportunities* of the poor (by means of, among other things, macroeconomic stability, growth and employment generation, and redistribution of assets).
- b. Increase the poor's *capabilities* (mainly by increasing access to education and health care);
- c. Provide more *security* (by taking measures to reduce the vulnerability of poor households due to economic volatility, natural disasters and environmental degradation, as well as due to the insecurity caused by criminality, terrorism and civil war); and,
- d. *Empowerment* of the poor (to improve their influence in decision-making by means of more participatory processes).

The PRSPs of each country should clearly state how these four dimensions are connected and relate to each other, and define priority actions to be taken depending on poverty characteristics.

3.4 Evaluating Poverty Reduction Strategies and Pro-poor Growth in Practice

3.4.1 How is poverty defined?

To a large extent the PRSPs carried out in a number of countries – and the ones of Bolivia, Honduras and Nicaragua are no exception – make use of a multidimensional definition of poverty and design lines of action around the dimensions of opportunities, capacity, security and empowerment. However, in practice the debate on pro-poor growth is again about the relation between growth and income poverty. In other words, it has a one-dimensional focus according to which poverty is seen as lack of income.

Similarly, the PRSPs in Bolivia, Honduras and Nicaragua, as we will see further below, stress that economic growth is the first step towards poverty reduction. With respect to increasing the “growth-poverty elasticity” or reducing inequality, the PRSPs emphasize increasing social expenditure and target these better towards the poor. In principle, this could be consistent with the above-mentioned policy framework in the sense that increased

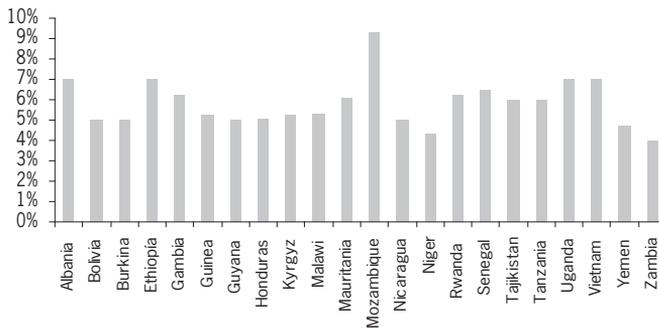
efficiency in social expenditure would result in improved capabilities (by means of investments in education and health) and reduced vulnerability of the poor to income risks. However, there are a number of questions and dilemmas that tend to be treated less clearly in the PRSPs, particularly the trade-offs that can exist between the strategy's different components and between what can be feasibly achieved in the short and long-term.

3.4.2 Too optimistic growth expectations?

Economic growth has become both a means and an end of the poverty reduction strategies. High and sustainable levels of growth are necessary conditions in all PRSPs. As in the structural adjustment programs, the PRSPs establish a target for economic growth. Initial growth targets of the PRSPs have been set according to the required level of growth rather than the level that would be realistically achievable. Consequently, projections of the fiscal balances that would be consistent with the planned rise in social expenditures depend on the optimistic economic growth targets, thus showing an optimistic view of fiscal solvency underpinning the strategy.

In retrospect the PRSPs – in general, not only those of our three countries – tend to assume growth levels that are rather optimistic. Initial PRSPs projected annual GDP growth rates of 6% on average, ranging from 4% (Zambia) to 9% (Mozambique) – see Graph 1.

Graph 1: Economic growth foreseen in the PRSPs, several countries



Source: IMF, PRSPs, various years.

Bolivia, Honduras and Nicaragua had an average of 5% as the target. In practice countries with a PRSP only reached an average growth level of 4% a year between 1999 and 2002. In many cases the deviation from

the target was greater than the average growth. In Bolivia, Honduras and Nicaragua actual growth was far below the target (see ISS 2003a: Table 3.2b; and Table 6 below).

What are the imminent risks in projecting scenarios that are excessively optimistic? Higher economic growth would make it possible to improve domestic sources of income and increase tax collection as a result of the expansion of economic activity. Those sources of income are seen as being fundamental to finance poverty reduction programs, since the objective is to reduce foreign sources of financing and replace them with domestic revenue. Consequently, the programs evidence a recurring gap between the envisaged funding and actual needs. On the other hand, with an increased GDP the relation public (foreign) debt/GDP looks more sustainable through time, which can lead to an incorrect assessment of the external debt sustainability. Also, achievement of the Millennium Development Goals is also projected on the basis of these assumptions about economic growth. The projected growth rates thus not only have become a variable of relevance for domestic policy making, but also of international commitment.

3.4.3 Comparison of GDP growth

Bolivia, Honduras and Nicaragua have shown a modest growth performance in 2003. In all three cases growth was higher though than in preceding years. This growth has not led to much poverty reduction. In Honduras, although last year's growth was higher than the adjusted target of the First Progress Report of December 2003 (but inferior to the original PRSP), it was insufficient to meet the poverty reduction target for that year (see ISS 2004b). In Bolivia, the instability that affects the country has outweighed the effects of increased social expenditure on the reduction of monetary poverty. Nicaragua's economy bounced back in 2003 after a three-year recession. However, debt-servicing has been given priority over social expenditures. Stability efforts are fragile due to a lack institutional development, development of human capabilities and empowerment.

Table 6: Comparison of GDP growth (%)

	Bolivia	Honduras	Nicaragua
2001	1.2	2.6	3.3
2002	2.5	2.7	1.0
2003	2.5	3.2	2.3

Source: IMF data.

3.4.4 How to grow?

An initial question is ‘what are the assumptions underneath those optimistic growth projections in the PRSPs?’ The experience of poor countries in Latin America precisely has been a lack of high and sustained economic growth. In addition, growth has been highly volatile. The economies of these countries went into recession in the years after the introduction of the PRSPs. In such a context, what can one expect from the reforms proposed by the poverty reduction strategy? Can they effectively create the basis for growth path that is more sustainable and less vulnerable to external shocks?

So far, the adopted reforms and policies¹¹ have been insufficient to tackle the enormous growth volatility that the region has faced. Among the main causes of volatility are the high concentration of a small number of primary products in output and exports, the persisting dependence on foreign financing, and a seminal uncertainty about policy priorities and inconsistency in the use of economic policy instruments (Hausmann and Gavin 1997). Weak institutions, weak governance, and the lack of productivity growth are part of the above-mentioned causes.

Within a context of economic volatility it is difficult to propose long-term policies aiming at solving the intertemporal trade-off between investments required for sustainable and pro-poor growth in the long run (e.g., investing in education, infrastructure, etc.) and the scarcity of (or at least instability in) the resources required to finance those investments in the short run.

A core question of the present report is: how do the PRSPs of Bolivia, Honduras and Nicaragua propose to resolve this trade off?

3.4.5 How to redistribute?

Given high income inequality, pro-poor growth requires income and wealth redistribution in the three countries. Distribution is relevant in any of the definitions of pro-poor growth. The second definition, which states that pro-poor growth is one that leads to the “maximum possible poverty reduction”, also emphasizes the need to deal with the distributive effects of growth.

Income and wealth redistribution can be reached by means of:

- (i) a change in the pattern of growth, facilitating greater employment generation and increased remuneration for the low-income groups;

¹¹ In general terms one can speak of the implementation of reforms and policies along the lines of the Washington Consensus, although the degree and consistency of the implementation of those reforms has varied substantially from country to country. ISS (2003a) presents a brief evaluation of the Washington Consensus Agenda in Latin America. For this reason, this document does not dwell on this topic. See also Behrman, Birdsall and Székely (2001) and Birdsall and De la Torre (2001).

- (ii) higher investments in human capabilities (for instance in education and health, and also by providing the poor with better access to productive and financial assets);
- (iii) redistributive fiscal policies. These three mechanisms are not mutually excluding and should in fact reinforce one another.

The roots of high inequality levels in Latin America are to be found in the region's history. Inequities are rooted in the pattern of growth, in the historically grown political obstacles to carry out redistribution of productive assets and eliminate inequalities in social expenditure, and in the fiscal structure, as demonstrated by a recent World Bank study (2003b).

During the 1990s, when structural adjustment and other major economic reforms took place, income distribution in most countries of the region became even more unequal. Particularly, the labour market adjustment produced widening wage gaps between skilled and unskilled workers and between those with a stable job in the modern sectors and those with low job security in the informal sector.

Recent studies such as Vos, Taylor and Paes de Barros (2002) and Ganuza, Morley, Robinson and Vos (2004, 2006) demonstrate that the exact causes behind this trend towards greater inequality differ from country to country, depending on the structure of the economy. Despite the greater inequality, they conclude that trade liberalization mostly had a slight, but positive effect on poverty reduction, because of positive aggregate employment effects. Other reforms such as capital account opening, financial liberalization and stop-go macroeconomic policies have had a much greater impact on inequality and poverty, producing volatility in the rate of poverty (Taylor and Vos 2002).

In any case, the opening of the economies has not succeeded in producing a more equal growth in most countries of the region. If there is more inequality, then higher growth rates are needed to achieve poverty reduction. As we will see further below, PRSPs generally do not question the economic reforms carried out in the 1990s. They rather intend to complement those reforms (and/or alleviate adverse impacts) by means of some redistribution through social expenditure. It is expected that increased investments in education, health and rural development, among others, will contribute to enhance competitiveness and boost economic growth.

In order to make systematic the qualitative analysis of the set of pro-poor policies and their perceived effectiveness, we apply a simple framework to establish a classification of policies, see chapter 4.

Methodological Note:

A Taxonomy of Pro-poor Policies

In order to make systematic the qualitative analysis of the set of policies and their perceived effectiveness, we apply a simple framework to establish a classification – or ‘taxonomy’ – into types. The analytical framework is inspired by the studies of Krueger (2000) and Behrman (2002).

4.1 Options in the Taxonomy

There will be several ways to classify policies:

- a) *Policies that have been implemented.* Should we focus on the current policies, the proposed policies, or the alternative options? For the purpose of this report we will focus on the policies that have been implemented and/or have been agreed in the PRSP framework.
- b) *Real impact.* Should we classify policies according to their objectives (as stated in the PRSP) or their results (observed or expected) on the basis of a rigorous policy evaluation? Our intention is to concentrate on the perceived real impacts, mainly based on rigorous studies. We will take into account the perceptions of stakeholders, but not as the main criteria to categorize policies.
- c) *Both short-term and long-term impact.* Should we consider short-term or long-term impacts? In fact, one should look at both. One of the key aspects of the growth-poverty link is that there are likely inter-temporal tradeoffs of the sort mentioned earlier, such as investments in education and safety

nets which may have little payoff in terms of economic growth in the short run (or even have some negative consequences if improperly financed and generating real exchange rate appreciation due to the additional non-traded goods spending), but more positive growth spin-offs in the medium to long run. To deal with this the suggestion would be to draw up the taxonomy for the major policy areas twice: one considering short and the other long-run effects, indicating the expected or observed dynamics (see an example below).

- d) *Absolute income poverty and capabilities.* What should we place on the horizontal axis? As discussed above, we should preferably consider the multiple dimensions of poverty. However, to avoid dealing with too many dimensions, we will focus on changes in absolute income poverty.¹² On the other hand, we will emphasize expected changes in *capabilities* (education, health, etc.), viewing them as conditions for the poor to take greater advantage of economic *opportunities*.
- e) *Policy context.* Should one look at individual policies or policy packages? This is a more tricky issue as the impact of one policy may depend on the other. For instance, from the economic reform policy literature it is evident that financial liberalization policies are likely to be disastrous (both for growth and poverty) when conducted without macroeconomic stabilization and in an institutional context which lacks adequate bank supervision and regulation. The idea would be to consider the context in which policies are conducted. Thus, financial liberalization would end up in quadrant III when implemented in a poor macroeconomic environment and lack of institutional reform and in quadrant II (or perhaps I if the growth effect has strong employment implications or if the reforms also entail complementary credit schemes for small firms) if those conditions have been there (or appear to be there).

Another example could relate to agrarian reform policies. A land reform involving merely redistributing lands

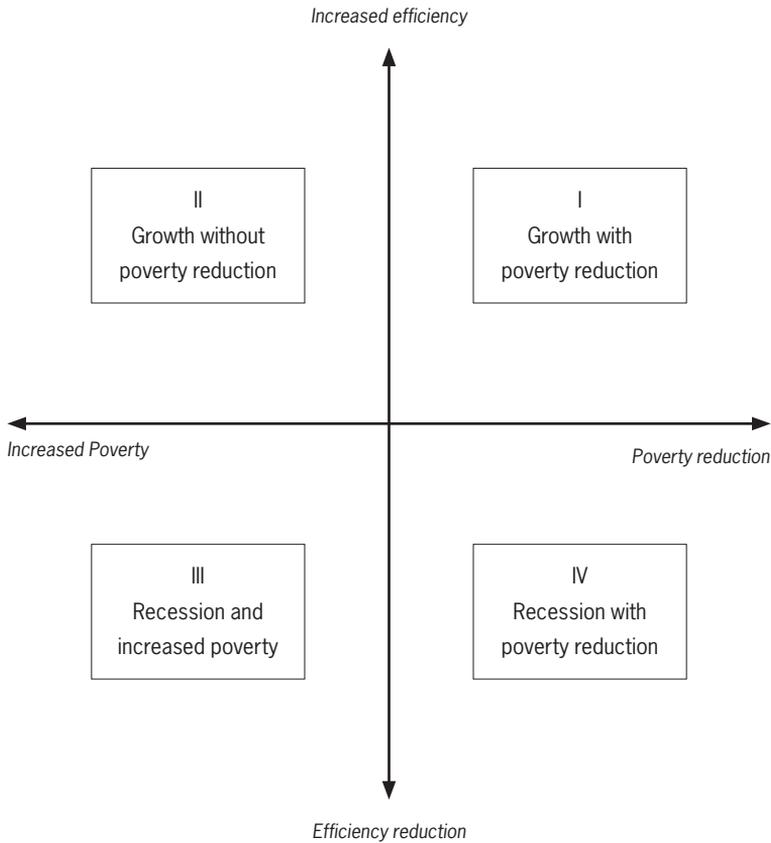
¹² Absolute poverty is defined as the situation in which an individual (or the household he or she belongs to) has insufficient means to meet the cost of a basket of goods satisfying a bundle of basic needs. In operational terms this is, mostly, measured by comparing one's income to an established poverty line.

to small (but essentially low-productivity) landholdings could enhance a class of poor farmers with poor growth perspectives and might end up being a “lose-lose” type of policy. However, when conducted together with rural development policies (infrastructure, improved inputs, credit schemes, and education) it may prove a “win-win” scenario, at least in the medium to long run.

- f) *Differentiation.* How should we account for heterogeneity among the poor? How should we consider the possibility that policies may need to be different across poverty conditions? If the aggregate poverty incidence is on the horizontal axis, we cannot be sure whether we are visualizing a temporary or permanent poverty variation and whether it reflects the net balance of winners and losers or gains for all poor. Where necessary we will therefore differentiate those impacts for different groups.
- g) *Political constraints / Stakeholder analysis.* What about political constraints? This will and should be a critical element, but possibly with a strong subjective component. This is where the stakeholder analysis should come in. Certain policies could potentially be labelled as pro-poor, but if they trigger conflict and political resistance they could prove to be anti-growth and anti-poor at the same time. One example would be a subsidy on basic food prices which favours mainly the urban middle class and works against the rural poor (farmers). Eliminating the subsidy could be a pro-poor move, however if it triggers strong urban resistance endangering political stability and/or leads to trade union pressures for wage hikes among the non-poor, it could be detrimental for growth and hurt both the urban and rural poor at the end of the day.

4.2 Taxonomy for Poverty Reduction and Economic Growth

A two-by-two matrix is used to assess how policies are linked to growth and poverty reduction. This matrix is presented in Graph 2.

Graph 2: Taxonomy for poverty reduction and economic growth

Source: Adapted from Krueger (2000) and Behrman (2002).

Along the vertical axis policies are categorized as enhancing economic growth (efficiency) or not, where enhanced growth is to be seen as bringing the economy to a higher, sustainable growth path, not just short-term growth stimulated by macroeconomic demand management.

Along the horizontal axis policies are categorized as to whether or not they help to reduce poverty. All policies can be put in one of the four quadrants of the matrix. There will be “win-win” policies that increase growth and incomes of the poor. These will be in the northeast quadrant I. “Lose-lose” policies are in southwest quadrant III if these generate a trap of lower growth and more poverty. Quadrants II and IV represent trade-offs between

the two types of outcomes. We would also expect there to be some symmetry in policies, in that the *removal* of “lose-lose” policies which hurt both growth and the poor will have a “win-win” result. The elimination of an inefficient subsidy that only benefits the rich could be of such a nature.

4.3 Example – No Active Anti-poverty Policies

When making the classification, it will be important to identify whether the expected outcomes are likely to be big (and economy-wide) or small (and local). If say the core set of policies as proposed under the PRSP all are located around the intersection of the vertical and horizontal axis (0,0), it would yield an aggregate picture of a strategy which does not make much difference from a situation without such policies.

Graph 3 sketches this situation.

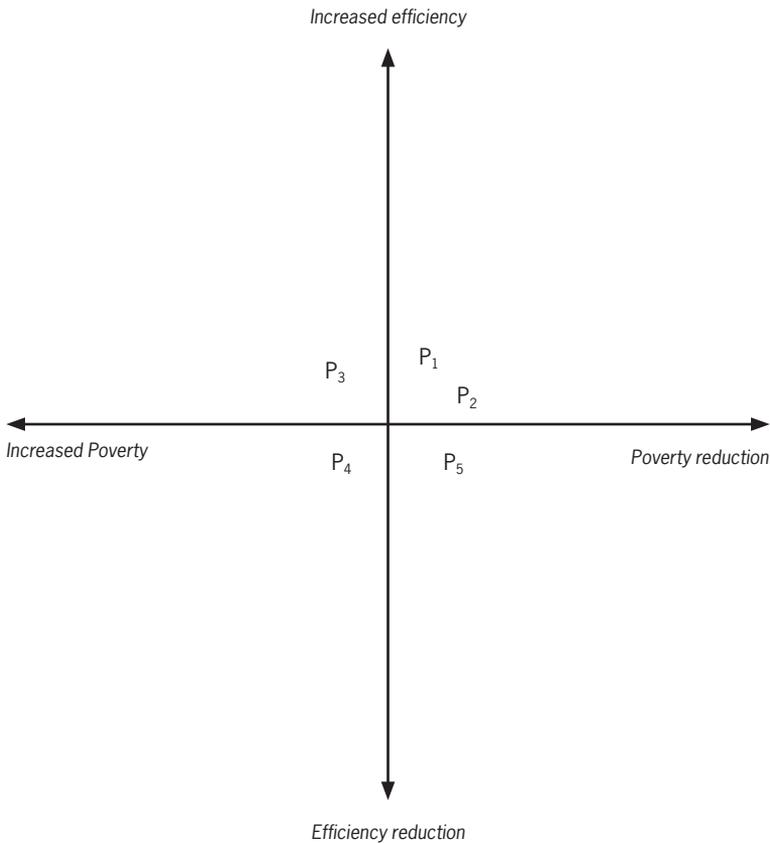
4.4 Example – Inequitable Growth and Redistributive Social Policies

In another scenario one could have effective, but unequal growth policies combined with strongly redistributive social policies. Consider a country rich in natural resources which chooses to invest heavily in, say, its natural gas sector (P_1). This should provide a stimulus to growth, but creates little employment and by itself would be anything but pro-poor and hence would be in quadrant II (see Graph 4).

Assume in addition that higher tax revenues from natural resource production are not enough to solve the country’s fiscal woes such that a tax reform (P_2) is carried out, increasing indirect taxes (VAT). The tax reform likely has a regressive income distribution effect, but by stimulating fiscal stability and by taxing consumers, the policy could stimulate growth, thus also ending up in quadrant II.

However, what if the increased fiscal revenues are used for a strong increase in pro-poor social spending (P_3)? Say, the additional revenue is allocated to a program of conditional cash transfers (e.g. like the PROGRESA/Oportunidades program in Mexico). Income poverty will fall in the short run due to the monetary transfers, while we would expect increases in capabilities (education, health) in the medium run. However, there could be short-run costs to growth. Such costs may emerge because the fiscal cost of the program exceed revenues generated by the tax reform or because of household responses to the transfer program, reducing labour participation (less child labour) with enhanced school enrolment. The redistributive social spending policies thus could end up in quadrant IV in the short-run, but with the expectation of shifting to quadrant I in the medium or long run.

Graph 3: Taxonomy A – No active poverty reduction policy (“business as usual”)



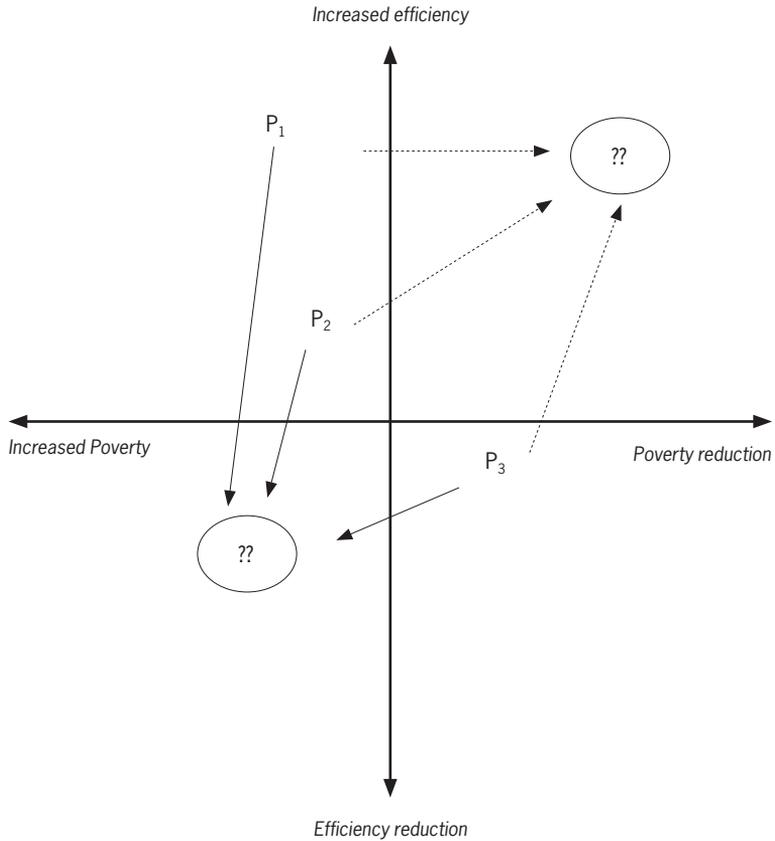
P₁, P₂, etc = policies that comprise the poverty reduction strategy.

Taken together, policies P₁–P₃ would constitute a “strategy” that maximizes economic growth and hopes to alleviate poverty through compensatory social programs.

As a first provocative hypothesis, we could question to what extent the PRSPs of Bolivia, Honduras and Nicaragua were according to the above classification. Was there concentrated growth with redistribution through social policies?

The subsequent questions would be: Is this the best way to move towards quadrant I (pro-poor growth) in the long run? Or would this transi-

Graph 4: Taxonomy B – Inequitable growth with pro-poor social spending in short run and uncertain outcomes in the long run



P_1 – P_3 = policies that constitute a “strategy” that maximizes economic growth and hopes to alleviate poverty through compensatory social programs.

tion be rather difficult and costly in social terms? For instance, there could be important losers in the short term and/or parts of the strategy could become politically conflictive (for example the tax reform) and hence economically ineffective. As a result, there is a risk that the economy would fall into a trap of low growth and persistent poverty (quadrant III).

Growth Performance During the 1990s

CHAPTER 5

5.1 Weak Economic Growth

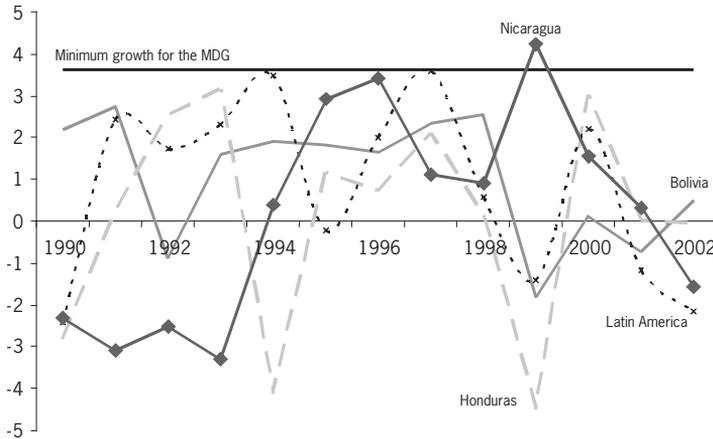
Growth performance improved in the three countries during the second half of the 1990s (see Graph 5), but *one cannot speak of sustained growth*. Economic growth has been weak, barely exceeding population growth. At the turn of the century, per capita income actually fell in Bolivia and Nicaragua and stagnated in Honduras (see Table 7). Due to high (and increasing) inequality, similar to the other countries of the region, growth has been insufficient to make a substantial impact on poverty reduction.

According to CEPAL (2003a), the countries of Latin America should reach an average annual growth of per capita income of 2.6% (equivalent to a total GDP growth rate of around 4%) for the next ten or fifteen years so as to achieve the first MDG (halving extreme poverty by 2015). For the countries with the highest poverty rates, sustainable growth in per capita income should be higher than 3.6% per year to achieve this goal.

As we will see further in chapter 6, these projections of required growth are extremely conservative for Bolivia, Honduras and Nicaragua, where poverty levels are much higher than the region's average. Nonetheless, even these growth targets are way above actual growth achieved in the 1990s. What is more, the countries need additional growth as they need to recover from the set backs in per capita income in recent years.

5.2 Volatility

The volatility that characterizes the region is very present in the three countries. In the macroeconomic realm, the reforms and policies of the 1990s were successful in reducing and stabilizing inflation, improving the fiscal balance, and (slightly) increasing exports. External shocks and fi-

Graph 5: GDP per capita growth (% per year), 1990–2002

Note: "Minimum growth for the MDG" is the minimum level of sustained growth required (from 2002 on) to achieve the Millennium Development Goal related to halving extreme poverty by 2015. It was calculated by CEPAL (2003a) as the average for the countries of the region with the highest poverty incidence in the late 1990s. As explained in the text, that minimum should probably be higher for Bolivia, Honduras and Nicaragua.

Source: World Bank, WDI, 2004; and Central Bank – Nicaragua.

financial crises have undone much of the benefits of these reforms. Both Nicaragua and Bolivia suffered two severe crises during the past decade. The poor were hurt most by these crises. The poor are particularly vulnerable to economic volatility, because of weak social protection systems and as significant fiscal resources have been used to strengthen the financial system often to the detriment of social spending.

5.3 Structural Change without Economic Diversification

During the 1990s the agricultural sector lost importance in the composition of output in Bolivia and Honduras.¹³ The reduced importance of agriculture was not accompanied by a greater diversification of production and exports. Production is still concentrated on few activities with limited value added. Bolivia's main exports are natural gas, metals, vegetable oil and soy. In the 1990s natural gas lost importance, but soy gained. Gas ex-

¹³ Data from CEPAL show that agricultural activities have gained importance in Nicaragua in the 1990s.

Table 7: Income distribution and growth in some Latin American countries

	Gini Index		Relation average per capita income rich/poor (5th Quintile/1st Quintile)		GDP per capita growth	
	1990	2002	1990	2002	1990– 2000	2000– 2002
Bolivia^a	0.54	0.61	21	44	1.2%	-0.1%
Brazil^b	0.63	0.64	35	37	1.3%	0.2%
Chile^c	0.55	0.56	18	19	4.9%	1.2%
El Salvador^d	0.51	0.53	17	20	2.6%	0.2%
Guatemala^e	0.58	0.54	27	19	1.4%	-0.3%
Honduras	0.62	0.59	31	26	0.4%	0.0%
Mexico^e	0.54	0.51	17	16	1.8%	-1.1%
Nicaragua^f	0.58	0.58	38	27	0.5%	-0.6%
Uruguay^g	0.49	0.46	9	10	2.3%	-7.7%
Venezuela	0.47	0.50	13	18	-0.1%	-5.0%

Notes on income distribution data:

All data on distribution refer to per capita income and are estimated according to household surveys. If not mentioned, these are national data.

(a) Bolivia: data for 1990 refer to 1989 for 8 cities and El Alto. For 2002 the figure is national.

Therefore, data for 1989 and 2002 are not comparable.

(b) Brazil: the second observation refers to 2001.

(c) Chile: the second observation refers to 2000.

(d) El Salvador: the first observation refers to 1995.

(e) Guatemala y Mexico: the first observation refers to 1989.

(f) Nicaragua: the first observation refers to 1993, the second to 2001.

(g) Uruguay: data refers to the urban total.

Source: CEPAL (2003a) for data on income distribution; World Bank, World Development Indicators (2004) for GDP growth.

ploitation is capital-intensive and has had a limited capacity of generating direct employment.¹⁴ In Honduras, coffee and banana have alternated as main export crops, with coffee taking the lead recently. Efforts to diversify export production have not made a major impact. Non-traditional products (pineapple, melon, shrimp, lobster and palm oil) make up less than 5% of agro-exports. In Nicaragua, the main export products are coffee,

¹⁴ Nina and Rubio (2000) have identified that growth rates and poverty-elasticity are positive in capital-intensive sectors.

sugar, meat, and – more recently – crustaceans. Most of these activities are relatively intensive in the use of unskilled labour.

Honduras' *maquila* industries are other important generators of foreign exchange and employment. These industries mainly employ unskilled labour. However, since 2001, these industries have stagnated due to the global economic slowdown and Asian competition.

5.4 Vulnerability of Foreign Exchange Revenues

Foreign direct investment (FDI) may promote higher economic growth without affecting debt sustainability. However, such capital inflows have been modest and falling in recent years. Poor infrastructure, low productivity and economic and political instability make the three countries little attractive to foreign investors. FDI increased in Bolivia, but investment was mainly in natural gas exploitation. FDI slowed down again because of the uncertainties surrounding the reforms in the sector. Honduras also saw some increases in FDI in manufacturing joint ventures. However, also in this case investment levels declined due to competition of other producers that are better vertically integrated and that offer superior-connected supply chains (CEPAL, 2003b). Workers remittances represent an important source of financing in the region, 40% higher than the inflow of FDI. Honduras and Nicaragua have the highest levels (Orozco 2003 and Table 8), but again their vulnerability and the social implications of international migration are a matter of concern.

5.5 Rural-urban Migration

Rural-urban migration has been strong in the three countries during the 1990s. The share of the rural population also declined because of migration to abroad. (The rural question is briefly analyzed below, see 5.8.) Rural-urban migration is mainly explained by better job opportunities, better infrastructure and service conditions, and the difference in wage levels. The latter derives from the deterioration of the terms of trade between agricultural and off-farm products as a result of the important growth of non-traded activities in urban areas. Regional disparities compound these demographic changes. In the coffee-producing central region of Nicaragua, the fall in coffee prices led to a rise in poverty during 1998–2001. In contrast, the rural Pacific region witnessed economic recovery thanks to the reconstruction of infrastructure in the aftermath of Hurricane Mitch.

Table 8: Selected economic indicators for Bolivia, Honduras and Nicaragua

	Bolivia		Honduras		Nicaragua	
	1990	2001	1990	2001	1990	2001
Per capita income in USD (1990 prices)	795.7	943.7	686.3	709.1	558.5	492
<i>Integration with the world (% of GDP)</i>						
Commodity trade balance	1.1	-2.6	-0.4	-12.7	-22.5	-37.2
Net flow of private capital	0.1	8.0	2.5	2.0	2.0	0.5
Net Foreign Direct Investment	0.6	8.3	1.4	3.1	0.0	5.2
External debt service (% of exports of goods and services)	33.5	16.1	33	5.7	2.3	22.2
Public dept (% of GDP)	92	60	131	81	1,088	176
Workers remittances (USD millions)	4	135	63	541	0	336
<i>Production structures (% of GDP)</i>						
Value added Agriculture	17	16	22	14	31	na
Value added Industry	35	29	26	32	21	na
Vale added Services	48	56	51	55	48	na
Urban unemployment	7.3	8.5	7.8	5.9	7.6	10.7

Source: CEPAL, *Anuario Estadístico 2002*; World Bank, *World Development Indicators*, 2003.

5.6 Social Expenditure

Most social expenditures go to education and health (Table 9). Social expenditure as a share of GDP increased in the three countries during the 1990s. However, compared to the other countries of the region, Honduras and Nicaragua show the lowest level of social expenditure per capita.¹⁵ Only Bolivia has a relatively high per capita expenditure level given its low per capita income. Social spending in Bolivia increased in recent years due to the incorporation of social security as part of the reforms applied to the pension system.

¹⁵ Argentina and Uruguay have the highest per capita social expenditure: USD 1,650 and USD 1,494, respectively (CEPAL 2002).

Table 9: Public social expenditures in Bolivia, Honduras and Nicaragua

	Bolivia		Honduras		Nicaragua		Latin America *	
	1996	2000	1996	2000	1996	2000	1996	2000
	-97	-01	-97	-01	-97	-01	-97	-01
<i>Social public expend</i>								
<i>(a+b+c+d)</i>								
Per capita	147	183	57	77	47	61	433	494
% of GDP	14.7	17.9	7.1	10.0	11.3	13.2	11.8	13.5
<i>Education (a)</i>								
Per capita	59	66	28	45	21	28	111	131
% of GDP	5.9	6.5	3.5	5.7	5.0	6.1	3.7	4.2
<i>Health (b)</i>								
Per capita	34	38	17	24	18	22	88	102
% of GDP	3.4	3.7	2.2	3.1	4.3	4.8	2.7	3.0
<i>Social security (c)</i>								
Per capita	26	47	11	2	8	1	39	217
% of GDP	2.6	4.6	1.4	0.2	2.0	0.2	1.2	4.8
<i>Social expend housing (d)</i>								
Per capita	28	33	1	7	0	10	195	46
% of GDP	2.8	3.2	0.0	0.9	0	2.2	4.2	1.4

Note: * Latin America includes the results for the 18 countries of the region for each period.

Source: CEPAL (2003a).

5.7 Lacking Adequate Social Protection Systems

The three countries lack adequate social protection systems to counterbalance the impact of adverse external economic shocks and natural disasters that generally victimize the poor.

In the case of Honduras and Nicaragua, national strategies to reduce the impact of natural disasters have not materialized. It is true that the development of this kind of program depends on the availability of resources, which are normally easier to obtain as emergency relief *after a disaster*. However, typically insufficient resources are made available to deal with both reconstruction costs and preventive programs. In Honduras such costs were estimated at 95% of GDP of 1998. In Nicaragua this amounted to 57% of the GDP.

The three countries have some experience with new social protection programs (social investment funds and the employment programs in Bolivia). However, their design and/or scope have been unable to provide adequate social protection in response to the impact of macroeconomic shocks.

5.8 Women in Rural Areas Particularly Affected by Severe Poverty

Poverty in Latin America has two different faces, when accounting for spatial differentiation between urban and rural, being more acute in rural areas. Although population is concentrated in urban areas, poverty indicators are more alarming in rural areas and they particularly affect women.

Poverty conditions in rural areas are firstly associated with employment opportunities (see Table 10).

Honduras, the country with the highest rates of general and extreme poverty, has 51% of the rural EAP working. If on the one hand employment opportunities make it possible to distance the population from the poverty line, it is necessary to note that self-employed activities are still poorly paid, particularly those linked to agricultural activities.

In Bolivia, where occupation in self-employed agricultural activities is important (79%), income is insufficient to pass the poverty line. Therefore, although there are differences among the three countries with regard to the employment opportunities in rural areas, there are similarities in the low remuneration provided by those activities.

Furthermore, limited human capabilities as reflected in high illiteracy rates and scarce public service provision (see Table 11) have also affected poverty conditions. Education programs should prioritize illiteracy reduction in rural areas, mainly female illiteracy, as a first step to integrate the population to the productive system.

5.9 Prospects of Pro-poor Growth According to the PRSPs

None of the three countries show consensus about what pro-poor growth means. Different stakeholders tend to have different concepts. As we have argued, also the academic debate lacks such consensus. Consequently, it is unsurprising that the actual policy debates do not stick to one single definition, but instead tend to be marred by a wide array of imprecise concepts. (See the country-specific descriptions below.)

In essence, the PRSPs of Bolivia, Honduras and Nicaragua aim at reaching higher economic growth on the basis of structural adjustment policies and economic reforms. These growth-promoting policies are

Table 10: Rural poverty and employment – Bolivia, Honduras and Nicaragua

	Bolivia	Honduras	Nicaragua
<i>General Poverty % (CEPAL)</i>			
National	62,4	77,3	69,3
Urban	52	66,7	63,8
Rural	79,2	86,1	76,9
<i>Extreme Poverty %</i>			
National	37	54	42
Urban	21	37	33
Rural	63	70	55
Rural pop. as % of total (NSO)	37,6	46,4	43,5
Rural employment as % of total EAP	62,8	51,3	57,4
Women (NSO)	35		31,7
<i>% rural EAP for each occupational category (CEPAL)</i>			
Employers	4,2	1,3	5,4
Wage earners	9,8	35	37,4
Self-employed	86	63,7	57,2
Agriculture	79	46,9	44,5
<i>Income of the EAP (times the corresponding poverty line) (CEPAL)</i>			
Employers	4,1	6,3	4,6
Wage earners	3,4	1,9	2,6
Self-employed	0,8	1,1	1,1
Agriculture	0,6	1	0,8
<i>Income distribution by deciles % (CEPAL)</i>			
Poorest 40%	8,2	15,4	14,3
30–70%	21,6	23,1	26,4
70–90%	30,7	28,3	28,6
Richest 10%	39,5	33,2	30,7

Note: The data correspond to 2001

Source: World Bank; National Statistical Offices (NSO); CEPAL.

Table 11: Illiteracy rate and access to services in rural areas

	Bolivia	Honduras	Nicaragua
<i>Illiteracy rate % (NSO)</i>			
Urban	6,4	9,4	12,3
Women	10,0		7,2
Rural	25,8	28,4	32,8
Women	37,9		29
Drinkable water, rural areas % access	64	81	59
<i>Electricity % access</i>			
Urban	93.9*	94.8	91,3
Rural	25.0*	31.7	40,1

Notes: Data correspond to 2001

* Bolivia and Honduras 1996

Source: World Bank, National Statistical Offices (NSO); ECLAC

complemented by some redistributive policies through pro-poor social expenditures. The PRSPs do not devote much space to assess the (expected) impact of the economic reforms and generally fail to consider the possible trade-offs between the pattern of growth promoted by the reforms and the goal of achieving “the greatest possible poverty reduction”. Neither do they estimate the time required for pro-poor social spending to translate into poverty reduction. The latter is fundamental for the sustainability of the poverty reduction strategy, since – as indicated below – the degree of tolerance of civil society to accept the reforms related to the PRSP tends to be inversely related to the time lag with which economic growth and social spending trickle down to the poor. (See further the country-specific descriptions below.)

We apply the classification to the PRSPs of Bolivia, Honduras and Nicaragua in chapters 6 to 8 using the following sources of information:

- (a) Our own assessment of the policies proposed in the PRSPs and in the existing development agendas of the three countries.
- (b) Economic studies that assess the cost and benefits of existing policies adopted in the three countries.

- (c) Consultations with national stakeholders (government officials, representatives of civil society, NGO's and private sector, representatives of the donor community).
- (d) Consultations with national and international economic experts of economic development in the three countries.

Bolivia – Prospects for Pro-poor Growth According to the PRSPs

CHAPTER 6

6.1 Perceptions of Pro-poor Growth

In Bolivia, stakeholders generally associate the concept of pro-poor growth with the fight against *monetary* poverty, rather than with non-monetary poverty. In the past, Bolivia has been more successful in reducing non-monetary poverty (education, health), than in reducing income poverty (ISS 2004a). One widely applied notion of pro-poor growth in the country is that of “broad-based growth”; that is, a pattern of growth benefiting broad segments of the population, including the poor. In a general sense, broad-based growth would imply a different pattern of growth from that witnessed during the 1990s, which is seen *not* to have benefited the poor. Nonetheless, none of the interviewed stakeholders – except for some economic experts – could provide any idea of what broad-based growth would entail precisely. The stakeholders are also unable to provide concrete ideas of what specific policies would constitute a broad-based growth strategy and disagreed about which economic sectors should be the main drivers of a pro-poor growth engine. Hence, while there seems to be a consensus that in order to reduce poverty some form of broad-based growth must be attained, there is no agreement as to what this means exactly and less so how to achieve it.

6.2 Policies toward Poverty Reduction

The Bolivian economy managed a moderate pace of growth during the 1990s. Between 1990 and 1998 (with the exception of 1992), annual GDP growth oscillated between 4.3 and 5.3%. Growth was higher than population growth and income per capita thus also increased every year during that period, except for 1992 (see Graph 5). Between 1999 and 2003

economic growth slowed down, varying between 0.4% and 3.0%. Due to the absence of comparable data for household incomes, it is difficult to obtain a precise measure of the impact of growth on poverty during the 90s. A cautious interpretation of the available data would suggest that both the number of people below the poverty line and the degree of income inequality increased or, at best, remained roughly constant during the growth period (ISS 2004a). This suggests that growth has not been pro-poor. In the main cities, average labour income in the main occupation of workers dropped by 13% in real terms between 1993 and 2002. In rural areas real labour income decline dropped by 40% between 1997 and 2002 (Jiménez and Landa 2004). Relative prices of agricultural products sold on the domestic market and source of income for many rural poor have also fallen.

Several recent studies have tried to estimate (with different methodologies) whether Bolivia witnessed pro-poor growth at some point. Data problems and the different definitions of the concept complicate this analysis. Table 12 shows that conclusions vary depending on which methodology (and definition) is used, the area that is being analyzed, the period considered, and the data source.¹⁶ The most optimistic study is that of Klasen et al. (2004), which clearly favours the conclusion that there has been pro-poor growth. Jiménez and Landa (2004) reach a more ambiguous conclusion based on alternative methodologies.

Table 12: Alternative views of pro-poor growth in Bolivia

Period and area	Pro-poor growth?	Methodology	Study and data used
<i>1989–2002</i>			
Bolivia	Yes*	GIC ("growth incidence curve")	Klasen et al 2004
Capital cities	No	GIC	Klasen et al 2004
Other cities	Yes – strong	GIC	Klasen et al 2004
Rural areas	Yes – moderated	GIC	Klasen et al 2004
<i>1989–1999</i>			
Bolivia	Yes	GIC	Klasen et al 2004
Capital cities	Yes	GIC	Klasen et al 2004

¹⁶ For a description of the different methodologies see Jiménez and Landa (2004).

Period and area	Pro-poor growth?	Methodology	Study and data used
Other cities	Yes	GIC	Klasen et al 2004
Rural areas	Yes	GIC	Klasen et al 2004
<i>1993–1997</i>			
Capital cities	Yes	GIC	WB 2004: main activity income
Capital cities	Possibly	GIC	Jiménez and Landa 2004: main activity income
<i>1993–1999</i>			
Capital cities	Yes – weak	Decomposition of poverty reduction (Ravallion and Chen)	Jiménez and Landa 2004
<i>1993–2002</i>			
Capital cities	No	PEGR (Poverty Equiv- alent Growth Rate)	Jiménez and Landa 2004
<i>1999–2002</i>			
Bolivia	Yes	PGC (Poverty-growth curve)	Jiménez and Landa 2004
Bolivia	No	PEGR	Jiménez and Landa 2004
Urban areas	No	GIC	Jiménez and Landa 2004
Urban areas	No	Decomposition	Jiménez and Landa 2004
Urban areas	No	PEGR	Jiménez and Landa 2004
Urban areas	Yes	PGC	Jiménez and Landa 2004
Rural areas	No	GIC	Jiménez and Landa 2004
Rural areas	No	Decomposition	Jiménez and Landa 2004
Rural areas	No	PEGR	Jiménez and Landa 2004

Period and area	Pro-poor growth?	Methodology	Study and data used
Rural areas	Yes	PGC	Jiménez and Landa 2004
Capital cities	Yes	PGC	Jiménez and Landa 2004

Note: PEGR = Poverty Equivalent Growth Rate; PGC = Poverty-Growth Curve; GIC = 'Growth Incidence Curve' (measures income growth for each percentile of income distribution); Decomposition = Chen-Ravallion of decomposition method of growth and redistribution.

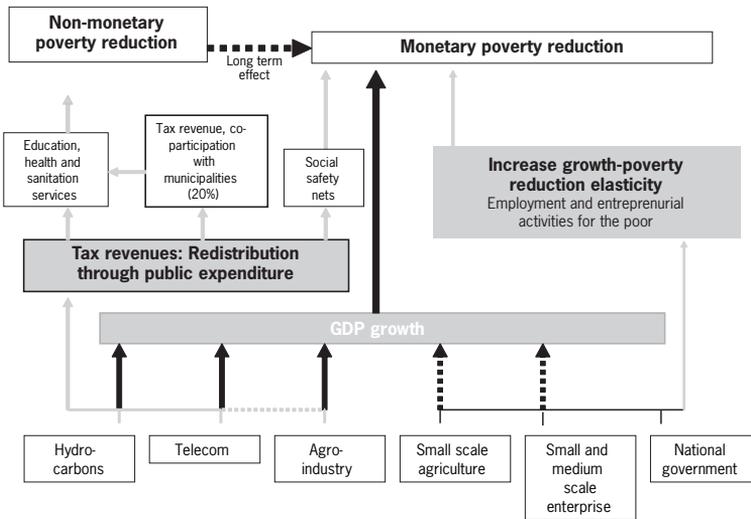
* Except for the poorest 10%

Although their impact is not very clear, poverty reduction policies during the 1990s can be mainly characterized as oriented at *growth* (based on macroeconomic stability) *with redistribution* (by means of social expenditure and investment at the national and municipal levels). The donor community has supported this strategy with aid for social programs and policy conditionality attached to donor lending (macroeconomic stability, fiscal and tax reforms, and protection of social expenditure). To government and donors alike, protection of social expenditure and popular participation became almost a synonym to combating poverty in Bolivia. The basic underlying assumption is that the reduction of non-monetary poverty will eventually lead to monetary poverty reduction.

The *Estrategia Boliviana de Reducción de la Pobreza*, EBRP, fundamentally represents the continuation of development policies of the 1990s. It intends to stimulate growth in the modern sectors of the economy (central path in black in Graph 6), which will help increase government revenue (left-hand path) and this will permit more redistribution through social programs satisfying basic needs (education, health, water and sanitation).¹⁷

The EBRP adds two lines of action to this basic strategy. First, it aims at strengthening the social protection network for the poor. Second, it acknowledges that in order to generate pro-poor growth it is necessary to find a way to improve the growth-poverty elasticity (path on the right-hand side of Graph 6). To do so, the EBRP proposes to support micro enterprises (in rural and urban areas) and create an emergency employment program through public works. Those programs were already present in Bolivia before the PRSP, but the EBRP confirms the government's commitment to put greater emphasis on these interventions.

¹⁷ A possible problem with this strategy is that not all dynamic sectors of the economy are sufficiently taxed, such as the agro-industries.

Graph 6: Bolivia – Strategy to achieve pro-poor growth according to the EBRP

Source: ISS (2004a)

Over the past four years there has been increasing demand for a more active role of the state in supporting, promoting and encouraging transformations towards a “Productive Bolivia”, so as to generate broad-based growth. The government has other possibilities (apart from its capacity of investing in physical infrastructure) to support the private sector. The EBRP revised by the administration of President Sánchez de Lozada, the government plan of President Mesa, the new National Strategy of Agricultural and Rural Development (ENDAR),¹⁸ and the National Dialogue “Productive Bolivia” 2004 somehow respond to that demand. The program *Compro Boliviano* (“I buy Bolivian”) is a good example: using the purchasing power of the government to support national enterprises. ENDAR maintains continuity in the proposals for rural development and poverty reduction that were also present in the original PRSP and adds two modalities: local economic development and agro-production chains.

Many of the interviewed stakeholders further see an important role of the government in the financial sector, in order to solve the problem of a lack of access to credits to small farmers and that of limited agricultural financial products. Others ask for public-private transfers. Besides these

¹⁸ ENDAR is a revised version of the rural development strategy presented in 1996. It has no official implementation status yet, but has been presented as an input for the National Dialogue “Productive Bolivia”.

specific policy proposals, a number of interviewees emphasized the need for maintaining social and political stability in Bolivia, without which governmental actions will not have the desired effect.

6.3 Central Issues for Bolivia's Future

6.3.1 Natural gas

In this recent debate there are three topics that have been considered to be central for the future of the country. *First and foremost*, there is the issue of *natural gas*.

Estimates suggest that present reserves are large enough to increase the current level of exports by 400% over the next 20 years. However, how much to export, to whom, and how to use the resulting benefits are still highly polemic questions. The referendum carried out in 2004 provided popular support to maximize gas exports. The government will control the production process and the derived state revenues shall be used to increment social expenditure in education, health, sanitation and infrastructure. By making natural gas exports the engine of the growth process, the current pattern of growth is strengthened, as it is already heavily concentrated on natural resources and as redistribution is already attempted through investments in the capabilities of the poor. This way, the importance of the mechanisms on the left-hand side of the Graph 6 is “inflated” even more. On the other hand, the other topics that have gained relevance in the policy debate are of influence on how the mechanisms on the right-hand side will be worked out. That is, the effectiveness of those mechanisms will determine to what extent the pattern of growth can be changed towards greater employment generation and the inclusion of the poor.

6.3.2 Micro enterprises

Second, the support given to micro enterprises is the first among the above-mentioned topics. Micro enterprises in Bolivia get substantial attention as a component of a pro-poor growth strategy because most of the new jobs created by small-scale enterprises. The EBRP includes the provision of support in terms of investment in infrastructure, technical assistance, micro credits and improvements in the productive capabilities of the poor (education, health and housing). Special emphasis has been given to micro-credit schemes in the recent debate. However, the support to micro-enterprises is not new. There is some skepticism as to whether such support mechanism will make much of an impact on poverty reduction at the macro level, since in many cases they comprise informal activities of low

productivity and little dynamism (Jemio and Choque 2003). It is therefore questionable if the proposed measures will be able to raise productivity and dynamism of the country's micro enterprises as a whole. There is also doubt about whether they would be able to foster growth and have an impact beyond some poverty reduction at the local level.

6.3.3 Rural poverty reduction

Third, there is the proposal to stimulate supply chains in rural areas as a basis for rural poverty reduction.

The development of agro-production chains is linked to the program of local economic development (DEL), which details the development of specific territorial areas. A production chain is similar to the idea of clusters. It connects different agricultural productive units and other enterprises that intervene in the different stages of the economic process, from the producer to the consumer. In Bolivia fourteen supply chains have been selected for support. ENДАР presents this idea of clusters in a more social manner than previous approaches. The latter were more "economicist", emphasizing "feasible" activities and only fostering the productive potential.

However, critics of ENДАР point out that, despite its greater emphasis on equity considerations, there remains a bias towards export crops in the selection of clusters and that thereby the majority of small farmers (and consequently all indigenous peasants) without access to land and markets are by and large excluded.

The problems of unequal land distribution and lack of an adequate agrarian reform¹⁹ would therefore limit the possibility of developing production chains as a broad mechanism for rural poverty reduction. Another possible weakness in this strategy is the need of having large enterprises for the supply chain. Agro-industries are still underdeveloped and weak in Bolivia, with the exception of soy and a few other crops already produced with large-scale technologies. Therefore, while there is some room to better develop small-scale production in agriculture and off-farm activities, the potential for this as a macro-economic strategy for growth seems limited and gains likely will be concentrated in a reduced number of territories. Thus, one should not bear great expectations concerning the impact that the development this kind of activity can have on aggregate poverty in the short or mid-term.

With greater access to land there is some potential for the peasants in the area of Santa Cruz, although in the valleys and the Altiplano (where

¹⁹ See ISS (2004a: Box 6.1) and Kay (2004) for an analysis of the agrarian reform policy in Bolivia and the current limitations of land redistribution for poor peasants.

rural poverty is concentrated) this potential seems to be limited (with the exception of some localities and specific crops, such as quinoa). As a consequence, one should expect that migration movements towards the cities, Santa Cruz and abroad will expand in the coming future.

6.4 Proposed Strategy Unlikely to Succeed

It is doubtful that the EBRP's proposed strategy for pro-poor growth will bring Bolivia closer to achieving the MDG of poverty reduction. Available quantitative studies on the issue are consensual in stating that it is unlikely that Bolivia will reach that goal. A CEPAL-IPEA-PNUD study (2003) already concluded that, with the growth trends and income distribution of the 1990s, Bolivia will not achieve the MDG. According to the World Bank poverty study (2004b), in order to reach that goal the Bolivian economy would have to grow at a rate of 6.5% per capita per year during the next thirteen years, which means a twofold increase in per capita income. Even so, the MDG would not be reached in rural areas. The same study concludes that it will not be possible that Bolivia grows at this pace, even with significant reforms.

The study by Klasen et al (2004) predicts that with current policies it would be possible to achieve an annual GDP growth of around 4%. If the economy does not grow at 6.5% per capita per year, Bolivia will have to find a way to increase the net growth-poverty elasticity by means of redistributive policies and changes in the pattern of growth. Both the World Bank (2004b) and Klasen et al (2004) present simulations in search of policies that can lead to the achievement of that goal. They have not found any possible combination to that end. Given the above-mentioned limitations regarding the programs of support to micro enterprises and production chains, one should not expect that those components of the EBRP would change the above conclusions.

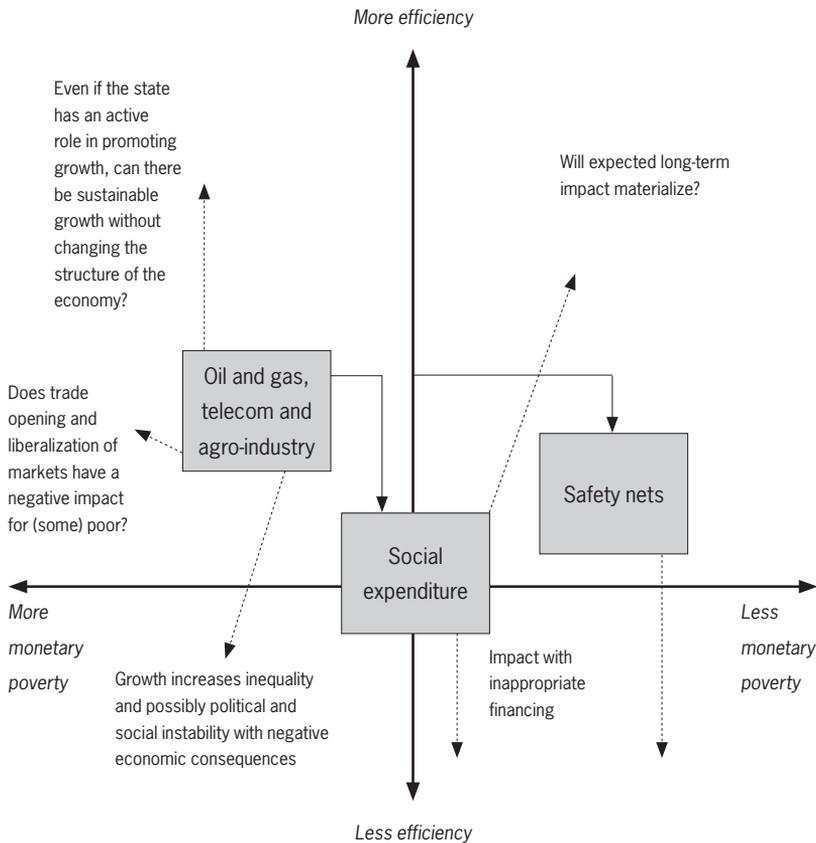
Given all restrictions and disadvantages of the Bolivian economy, natural gas seems to be the best opportunity that the country has to change its fate in coming years. It offers the possibility of significantly increasing government revenues and hence generating additional resources for investment in human capital and physical infrastructure, redistribution, and debt repayment. There is also the possibility of using gas and its derivatives not only for social investments but also to strengthen or create productive activities in the country.

However, the same opportunity poses great challenges to the country. The first is how to turn this possibility into real resources for the government. If there is agreement on gas exploitation and exports, then the sec-

ond challenge is to decide about how to use the resulting resources and/or who will get the decision-making power over them.

The long-term results of this strategy of growth and redistribution by means of social expenditure is obviously very uncertain, mainly when one considers the past trajectory of the country and as we suggest in the classification of pro-poor policies (see Graph 7).

Graph 7: Bolivia – Classification of the EBRP pro-poor policies



The revision of the EBRP is an opportunity to make progress in defining the redistribution strategy more clearly. Since, as seen above, following the existing growth pattern is not likely to have the desired impact on poverty

reduction, it seems important that those who participate in these discussions accept the need of questioning assumptions and opening up to less orthodox and controversial ideas. First of all, they should analyze why the current programs have not yielded the expected results. Implementation and/or conceptualization problems that affected those programs could also affect the new ones.

Honduras – Prospects for Pro-poor Growth According to the PRSPs

7.1 Perceptions of Pro-poor Growth

In *Honduras* none of the interviewed stakeholders appeared to be informed about the pro-poor growth debate taking place in academic circles or in key decision-making centers such as the international financial institutions (ISS 2004b). This lack of information was common among government authorities, civil society and more surprisingly among the international community in Honduras. This could be a sign that most of this debate is taking place in the headquarters of multilateral and bilateral donors rather than in the field (at least in the case of Honduras). The lack of clarity about the meaning of pro-poor growth has given rise to a wide range of policy approaches as how to achieve it.

The opinions of stakeholders on this matter can be classified in four groups:

- Few stakeholders (in fact only the IMF representative) defend the view that pro-poor growth is a new name for the classic phenomenon of economic growth, where consistent macroeconomic management guarantees its sustainability. In such a context, benefits from growth would trickle down to all of the population, including the poor.
- For some government officials and some bilateral donors pro-poor growth boils down in practice to the strengthening of the “growth pillar” within the PRSP. In this sense, growth should be consistent with the PRSP targets and policy change essentially implies correcting inequities in social policies of past government strategies.

- For other government officials and most interviewed representatives of the international community pro-poor growth policies are essentially those spelled out in the original PRSP, except that they give more importance to market solutions in the process of poverty reduction.
- Last but not least, a small segment of civil society identifies pro-poor growth (at least at the conceptual level) as a kind of labour-intensive growth generating employment for the poor. More jobs for poor households would be the key to generate the incomes required to improve living conditions and overcome poverty. Some suggest that the focus of such a strategy should be on a modernization of agriculture through agrarian reform, land titling, credit and technical assistance. Others opt for attempting to promote productive innovation among small and medium producers (*pymes*) by supporting the creation of clusters in sectors like the *maquila* industries and tourism.

Yet other stakeholders propose an alternative poverty reduction strategy concentrating interventions in the geographical locations where most poor live and which would optimize the use of the country's natural and human resources in the hydrographical basins. According to the advocates of this proposal, this would imply concentrating of the strategy's efforts in the Pacific side of Honduras.

7.2 Policies toward Poverty Reduction

During the 1990s, growth in Honduras was unstable and on average frustrating low when compared to neighboring countries. This panorama has not improved in recent years. Trade opening and liberalization of markets in the early 1990s attracted *maquila* industries to Honduras, as well as diversified exports towards non-traditional products (mainly garments and textiles). These industries have generated more employment opportunities and mainly improved female participation in the labour market.

As demonstrated by Cuesta and Sánchez (2004), trade liberalization and the expansion of the *maquila* sector have jointly led to a process of pro-poor growth in Honduras. Their analysis, based on a general equilibrium model for Honduras, also demonstrates that greater trade integration (for instance in a scenario of the Free Trade Agreement of the Americas, (FTAA)) would be pro-poor, provided that there are no changes in the other

factors that influence growth (see Table 13). An exogenous increase in the productivity of export sectors would also have a pro-poor effect.

It is important to highlight, however, that the simulated impacts both on growth and on poverty and distribution would be modest.

Table 13: The nature of economic growth in Honduras under different scenarios of trade integration and external shocks

(Results of counterfactual simulations using a CGE model for Honduras)

	Change in GDP	Change in poverty incidence	Change in inequality (Gini coef- ficient)	Impact
(1) FTAA agreement	1.21	-0.52	-0.18	Pro-poor growth
(2) WTO agreement	2.17	-0.85	-0.23	Pro-poor growth
(3) Unilateral reduction of 50% in tariffs	1.87	-0.97	-0.24	Pro-poor growth
(4) Unilateral increase of 50% in tariffs	-1.90	0.76	0.26	Pro-rich recession
(5) 10% reduction in cof- fee prices and 10% rise in oil prices	-0.31	0.07	-0.02	Recession with ambiguous redis- tributive effects
(6) 10% increase in produc- tivity of export industries	0.65	-0.16	-0.06	Pro-poor growth

Note: Results are presented as percentage changes from a baseline model solution.

Source: Cuesta and Sánchez (2004: Table 13.6).

However, this could give an over-optimistic picture of the transition to pro-poor growth in Honduras. First, apart from the traditional limitations of the assumptions needed to build a policy simulation model, the results suggest that the pro-poor impact is very moderate and could be easily eliminated by an adverse external shock (such as the current rise in oil prices). Such an adverse terms-of-trade shock tends to generate a pro-rich recession. Second, the diversification of exports towards the maquila has not helped reducing the vulnerability to external shocks, as these non-traditional exports have proved to be as fragile as the traditional ones. The maquila ‘boom’ was short-lived and its decline started in 1998. Nonetheless, the Honduran government proposed to further develop the process of trade integration and competitiveness as the central

axis for pro-poor growth. What are the potentials and risks associated with this strategy?

In terms of growth, the revised PRSP argues that the original strategy gave more emphasis to macroeconomic policies and to reforms oriented to improving the investment climate (GdH, 2004a; ISS 2004b). It openly recognizes that the deterioration in the macroeconomic and fiscal situation and the vulnerability to fluctuations in coffee and oil prices indicate that those macroeconomic and structural adjustment policies by themselves are not sufficient to ensure an annual growth rate of at least 4% (which is believed to be necessary to substantially reduce poverty). Subsequently, the revised PRSP suggests that the focus should be on the central pillar for growth (GdH, 2004a: 8). This implies that the government should give priority to investments in the infrastructure necessary 'to correct the deficit in quality and access to services' (GdH, 2004a: 9).

These investments are justified on the basis of their expected capacity to act on three different fronts:

- (a) to accelerate GDP growth;
- (b) to prepare the country to effectively compete within the regional integration between Central America and the us;
- (c) to create more economic opportunities for the poor.

7.2.1 Investments in infrastructure

Investments in infrastructure give priority to two kinds of projects:

- (i) *economic infrastructure*, that is, seaports, roads (rural roads and primary and secondary road networks), electricity and telecommunications; and
- (ii) what the PRSP calls *productive infrastructure*, particularly investments in irrigation systems. These investments are defended both for their efficiency and redistributive effects. The latter would derive from the employment generated for maintenance micro enterprises and poor families working for the construction sector.

However, the pro-poor nature of these measures is questioned by the Honduras country report of 2004 (ISS 2004b), since:

- a) investment in seaports does not have a clear direct impact on poverty reduction;
- b) only few (five) maintenance and support micro-enterprises will be involved in the construction of roads, with little measurable impact on direct employment for poor families;
- c) financial resources for the proposed investment in road construction, telephone and electricity networks are only partially covered and it is expected that the proposed price liberalization in these sectors will lead to price increases, consequently affecting poor users (González and Cuesta 2003); and
- d) the proposed investments in irrigation systems tend to mainly benefit large agro-exporters and will be allocated to the least poor rural municipalities.

7.2.2 Tourism

The other pillars of the revised PRSP are tourism and trade integration within the context of CAFTA, Central America's free trade agreement with the US. Through tourism promotion, it is expected that some inclusive development will be achieved in rural areas by improving the capacity to deliver tourist services through micro-enterprises and indigenous communities. Although there is a clear potential for employment generation through tourism development, it is not obvious beforehand that the projects proposed in the PRSP will as a whole have a pro-poor effect. Some projects are placed in the poorest areas (Copán), but the others are concentrated in the departments with the highest human development levels in the country (the development of tourism on the cost of the northern region). Additionally, the financing of projects requires a high contribution of private investment, which is not guaranteed by definition.

7.2.3 Trade integration

Trade integration within CAFTA is an important element of the strategy, although the revised PRSP dedicates remarkably little space to this agreement and its expected impact on poverty. The PRSP stresses that CAFTA requires that the agricultural sector become more competitive, but at the same time it observes with satisfaction the agreement includes permanent protection for white maize and a very gradual reduction of tariffs for other basic grains. Investments in irrigation systems, greater access to credit, and in-

creased agricultural education are all among the proposed measures to improve agricultural productivity. It is expected that CAFTA will boost the old comparative advantages of traditional export sectors, as well as some new sectors with high agricultural value added (African palm, melon, shrimps). As indicated above, the net impact could be moderately pro-poor. However, it is not obvious that CAFTA can compensate for the stagnation of the *maquila* industries and the movement of foreign investment away to Asia (China). Also the adverse impact of the current rise in oil prices is likely to offset CAFTA's expected benefits, at least in the short-run.

7.2.4 Macroeconomic and fiscal policy

The macroeconomic and fiscal policy presented in the revised PRSP are the same as in the original strategy, seeking greater fiscal discipline, tax reform, increased expenditures for poverty reduction, and maintenance of a competitive exchange rate despite the frequent devaluations of the lempira *vis-à-vis* the US dollar. Fiscal discipline was challenged in 2003–2004 due to the worsening of the social situation in the country. The inflationary effect derived from the rise in oil prices led to demands for higher wages (mainly by school teachers), which put pressure on abandoning fiscal objectives. The tax reforms of 2002 and 2003 aimed at enlarging the tax base, enhancing tax collection and improving income equality.

A recent World Bank study concludes that these reforms would be 'slightly progressive in redistributive terms' (World Bank 2004c: 1). However, this conclusion assumes that the expected growth in tax collection has already materialized, although the efficacy of the reforms still needs to be demonstrated in this sense. Further, the alleged progressive redistributive effect measured by the World Bank is measured with respect to household consumption. If one measures the impact *vis-à-vis* income distribution, it appears that the increase in tax payments by poor surmounts that of the non-poor (ISS 2004b: Box 2). Hence, the redistributive effect of the tax reforms remains in question. In fact, it is more likely that the pro-poor impact would come from the increased tax income resulting from such reforms. It is estimated (World Bank 2004c: Tables 6.3 and 6.6) that a per capita redistribution of the additional tax collection could reduce *extreme* poverty by 4% and the Gini coefficient by more than 2.5%. Nonetheless, the total poverty incidence would be expected to increase slightly by 0.5%.

By official accounts, pro-poor expenditures have expanded significantly. However, this holds for a very broad definition of social expenditure. It includes investments in infrastructure of which the pro-poor impact is not evident. Additionally, the financing of that increased social expenditure depends on the disbursement of the US\$ 1.8 billion pledged by the donor

community for the PRSP of Honduras. However, one does not know yet what will be the distribution and composition of those funds, nor the timing of the disbursements.

In sum, the PRSP proposes to turn the Honduran economy more competitive by means of investments in infrastructure, deeper trade integration and promotion of tourism. Government expects that these measures alone will yield pro-poor growth, which impact will be reinforced by the expansion of pro-poor expenditure.

Our classification of these policies (see Graph 8 for an overview) suggests that these expectations likely are over-optimistic and that the poverty and growth impact of the measures are rather uncertain. Besides, these proposals comprise nothing much new. The novelty compared to past policies is that they are expected to have a pro-poor impact. However, programs proposed in the PRSP need to be detailed much further in order to guarantee that they will yield benefits for the poor. In addition, the precise modes of implementation are still to be determined and the financing of the strategy still has many uncertainties.

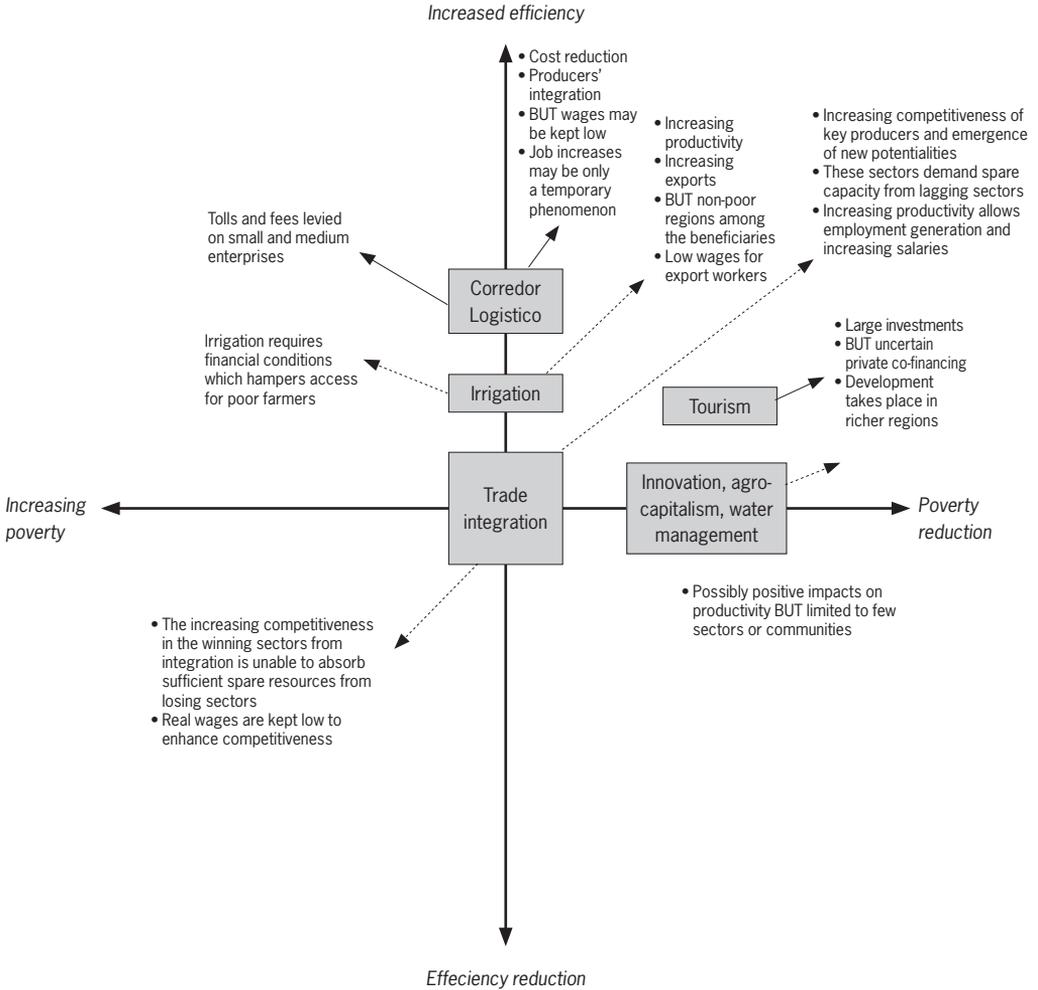
The classification of policies for Honduras shows that indeed a great deal of the envisaged impact concentrates on the northeast quadrant; that is, where economic growth goes hand in hand with poverty reduction. On the other hand, there are also possible outcomes that may fall in the quadrants of no growth and poverty reduction, growth with increasing poverty, and recession with increasing poverty (see Graph 8). As a result, it is hard to predict what it all adds up to. Interestingly, one can foresee that the magnitude of these identified impacts varies considerably from an expected strong growth with reduction of poverty (coming from expected efficiency gains from the infrastructure investments in the so-called ‘*corredor logístico*’) to strong negative effects on economic growth and poverty (resulting from unemployed resources not absorbed by sectors that gain from the regional trade agreement, CAFTA). Although the final outcome of these effects is difficult to predict, the important message is that not *any* single policy will yield pro-poor growth.

7.3 Proposal Based on Risk Assessment

The economic growth objectives are thus at risk in the first place, not only for the uncertainty of policy outcomes, but also – and maybe mainly – due to the traditional vulnerability of the economy to external shocks. This becomes patent when one observes the problems in meeting existing macroeconomic targets due to the rise in oil prices.

Second, in the near future Honduras will also face the consequences of the end of the Multi-Fiber Agreement, which will terminate in 2005

Graph 8: Honduras – Classification of the (revised) PRSP pro-poor policies



(or 2007 at most), affecting the maquila industry even more. Hence, Honduras should look for alternatives its “engine” of export growth and employment generation of the 1990s. The expected benefits to be brought by CAFTA and the modest efforts towards tourism promotion are unlikely sufficient to guarantee dynamic and stable sources of foreign currency.

Third, the poverty reduction strategy is at risk considering both the lack of concrete pro-poor policies and the trade-offs that can arise to the implementation of the growth strategy.

Nonetheless, recognizing these risks can become an advantage for the design of pro-poor growth policies. In the Honduras country report (ISS 2004b) there is a proposal based on such risk assessment. It comprises the *ex-ante* ranking of policies according to the criteria of economic and redistributive impacts that are favourable to growth. This kind of ordering is already carried out in the setting of priorities for the PRSP projects, providing consistency and rigour to the identification of priority initiatives (projects, programs or policies) within the overall objective of reducing poverty in Honduras. The proposal consists in assigning weights to the proposed policies according to their expected effects on a number of dimensions that are considered to be desirable for a pro-poor growth policy. The grading by dimension can be homogeneous or heterogeneous, depending on the importance assigned to the different criteria.

For instance, a preliminary ranking of policies could be based on the following criteria:

- (1) positive effects on employment, with additional weights if employment generation is sustained and focused on unskilled poor labour, mainly of vulnerable workers (peasants, women, and indigenous people);
- (2) wages of the newly employed workforce (and of already employed workers) are not reduced;
- (3) initiatives clearly identify mechanisms or practices that improve the productivity of labour and/or of other production factors;
- (4) initiatives should not only include a single community or sector, but show clear linkages at the regional or national levels, or among the different sectors of the economy;
- (5) the initiative or policy counts on sustainable and secure sources of funding for investments;
- (6) policies include contingency or compensation plans for those adversely affected. These criteria may help better informing public and political debates on pro-poor growth policies. Adding greater realism in the plans will also help bringing about effective implementation of pro-poor policies.

Nicaragua – Prospects for Pro-poor Growth According to the PRSPs

8.1 Perceptions of Pro-poor Growth

In *Nicaragua* the public debate about pro-poor growth is yet to begin (ISS 2004c). The original PRSP (*Estrategia Reforzada del Crecimiento Económico y la Reducción de la Pobreza, ERCERP*) stated, without mentioning the word pro-poor growth, that a “broad-based growth process” would be needed to generate sufficient jobs. Employment was considered the key determinant in the reduction of monetary poverty. While this view may still be present, the new agenda that has emerged focuses more on growth than on poverty reduction, since it is considered that ‘without growth there will be no employment generation and consequently no poverty reduction’. In essence, the main goal of the National Development Plan is to reach the highest possible economic growth rate. Employment creation and poverty reduction are believed to follow more or less automatically from there. Agents of civil society challenge this view, but not under the flag of pro-poor growth.

8.2 Policies toward Poverty Reduction

Since 1990s, the Nicaraguan economy has shown three faces. In contrast to other countries in the region, there has been no pressure to attract large private capital inflows or to implement expansionary macroeconomic policies. Between 1990 and 1995, annual GDP growth reached a meagre 1.5% (causing a decline of 1.2% in *per capita* income per year). Despite the lifting of the US commercial embargo, this implied a remarkably weak recovery after the 1980’s crisis. The important inflow of foreign aid largely contributed to the enactment of the stabilization plan and to the payment of foreign debt services, more than to economic growth (Vos 1998). Growth

became export-led following trade liberalization of the early 1990s. At the same time, however, import dependence increased significantly strongly, leading to a huge trade deficit (more than 25% of GDP), which was mostly financed by foreign aid. Weak growth performance in the first half of the 1990s was followed by strong economic expansion in the second half. GDP growth averaged 5.0% per year in that period. Improved terms of trade and accelerated export growth explain the upward growth cycle.

There are no comparable poverty data on poverty for the period as whole, but it is quite likely that poverty increased in the first half of the decade and decreased in the second half. From 1999 on, the economy entered into a recession, following the end of the national reconstruction plan related to Hurricane Mitch and a sharp decrease in the terms of trade, particularly due to the decline in coffee prices and the rise in the price of oil and derivatives. In this context, agriculture remained as the mainstay of economic activity. The agricultural sector contributes 32% of value added and 50% of exports (a much higher proportion compared to other countries of the region). The structure of exports also remained about the same, showing no diversification towards non-traditional products.

The ERCERP closely follows the guidelines of the PRSP Sourcebook, basing the strategy on four pillars: (i) *opportunities*: broad-based economic growth, emphasizing employment generation in the productive sectors and rural development; (ii) *capabilities*: increased and better investment in the human capital of the poor; (iii) *security*: improved protection to vulnerable population groups; and (iv) *empowerment*: institutional strengthening and good governance. These four pillars are interrelated to three cross-cutting themes that are also essential for the ERCERP: (i) reduce environmental degradation and vulnerability, (ii) increase equity; and (iii) decentralization.

The first pillar of ERCERP rests on the implementation of a program of sustainable economic stabilization and structural reform, which includes: the privatization of state-owned enterprises providing public services; modernizing and integrating the rural economy; encouraging small and medium enterprises; developing the Atlantic Coast; and developing strategic productive agglomerates (clusters). The strength of this pillar will depend on the dynamics of the private sector. According to the ERCERP, eventually it is the private – not the public – sector that will have to create more jobs, higher income and wealth in Nicaragua.

The strategy will try to promote incentives to rural development, through the elimination of price and cost distortions faced by farmers, improvements in the functioning of the rural factor market, increased investments in rural infrastructure, the implementation of programs aimed at small and medium producers with proved potential for growth, and

by supporting the development of better production technologies. The future agricultural (and exports) growth shall be the result of increased productivity, a key element in the ERCERP efforts.

In this sense, the ERCERP pays considerable attention to rural development because of the higher poverty incidence in rural areas and their high potential of sustained growth with abundant – although underemployed – production factors. Additionally, as they are labour intensive, agriculture and small and medium enterprises have great potential to reduce unemployment.

8.3 The National Development Plan

The National Development Plan (NDP) presented in 2003 puts more emphasis on *competitiveness*. New employment opportunities and economic growth are expected to be fostered by vibrant, innovative, competitive and successful businesses and productive sectors, enabling Nicaragua to reinsert itself in the regional and international markets through competitiveness. The development of competitiveness is based on four fundamental aspects: (1) support to small and medium enterprises; (2) attraction of foreign direct investment; (3) social inclusion through the development of human capital; and (4) basic infrastructure investment at the territorial level. To a much larger extent than the ERCERP, the NDP adopts the idea of developing productive clusters as the basis for leveraging productivity.

The policies proposed by the NDP, feature a vast program of *infrastructure investment*. An array of actions is proposed including an improved road network, investment in domestic energy sources – to reduce dependence on oil imports –, improved communication infrastructure and a housing program. Rural development plans emphasize the development of a modern capitalist agricultural sector. The NDP advocates the adoption of entrepreneurial attitudes by small-scale producers. That means eradicating the production logic of subsistence farming, replacing it by a business-minded behavior. In a country where the rural population represents a very high proportion of the total population and where the great majority of peasants face low marketable surpluses and difficult access to land and credit, enacting such a policy may have extraordinarily negative effects upon important groups of farmers.

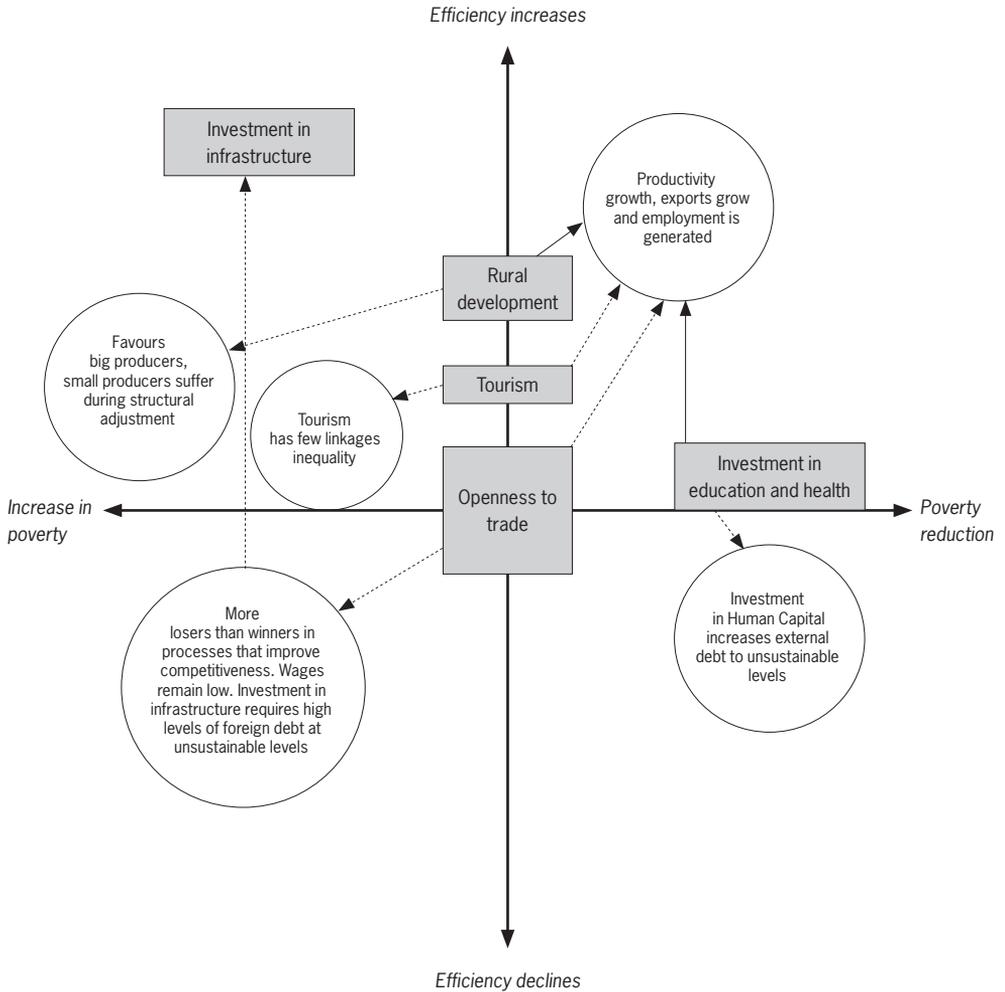
The objective of maximizing the country's growth potential is also reflected in the new formula in the NDP for allocating public investment resources and social expenditures across territories. Resources are to be allocated by the degree of extreme poverty (using a poverty map) as well as by the economic growth potential of localities.

Thus, both the ERCERP and the NDP prioritize economic growth (and, consequently, job creation) as the main mechanism to reduce poverty. The major difference between the two is that the ERCERP proposes a large set of social programs providing immediate benefits for the poor and targeted using the poverty map of Nicaragua. The NDP considers these programs to be “charitable” (“*asistencialista*”). Generally speaking, the NDP is based on a renewed concept of pro-poor expenditures in the following sense: (a) on a geographical perspective where poverty is associated with conditions of marginality and competitiveness of territories, adding a new criterion for allocating resources; (b) all economic development spending is considered pro-poor by definition, since economic growth is seen a necessary condition for reducing poverty through employment generation; (c) it advocates the efficient allocation of resources, leading to a revision of programs that were previously accounted as poverty reducing expenditure, but that should not be considered as such; and (d) a more structural view is taken towards social assistance, emphasizing investments in human capital, targeting social welfare programs, and renewing the concept of social safety nets.

The emphasis in searching for new sources of economic growth may be explained by the poor economic performance in recent years. However, as the CEPAL-IPEA-PNUD (2003) study clearly argues, accelerating growth will not be sufficient to reach the MDG of halving extreme poverty by 2015. In the 1990s, Nicaragua did not manage to reduce inequality. Under such conditions, *per capita* income would have to double from 2000 to 2015, requiring a 5% annual per capita growth rate, far beyond the NDP goals of growth. Nevertheless, if inequality is reduced by 3.6%, *per capita* income would have to grow at a sustained rate of 2.7% for the next fifteen years in order to achieve the MDG on poverty reduction. Nevertheless, also under this scenario the Nicaraguan economy would have to perform much better than historical trends and would have to compensate for its poor history of income redistribution in favour of low-income groups. As we have already mentioned, the current plans of deepened trade integration likely will bring little additional growth and will increase inequality. Can we expect anything better from the NDP if it materializes?

Our classification of the NDP policies suggests that we should not expect miracles. Just as in the cases of Honduras and Bolivia, the strategy promises much, but the expected impact in terms of pro-poor growth is uncertain. Graph 9 briefly shows that the results may follow in different directions.

Graph 9: Classification of the NDP pro-poor policies



8.4 The Impact of the Regional Trade Agreement, CAFTA

The Central American Free Trade Agreement (CAFTA) potentially has a serious impact on poverty in Nicaragua. On the production side, 58% of the agricultural output consists of the so-called “sensitive products”, which means that they are produced by small or medium-sized farms and are mainly sold at the domestic market. Lifting tariff barriers through

CAFTA will affect many of these products, even if Nicaragua is allowed to keep basic grains under protection for a longer period. As Vos and Sánchez (2006) analyze, the overall impact of tariff reduction and increased tariff-free export quota for a range of agricultural products into the United States market negotiated under CAFTA will have only a very small impact on the Nicaraguan economy. They show that additional GDP growth would be no more than 0.2 percentage points and there would be no discernible impact on overall poverty or inequality. The main reason for this limited impact in the aggregate is that, first, most import tariffs are already very low following trade liberalization of the early 1990s and, second, that gains and losses in different sectors more or less offset each other. The producers of group affected negatively. Producers of livestock and workers in the Export Processing Free Zone could gain from CAFTA. The agreement would also bring Nicaragua a significant increase in export quota for textiles and garments. If it manages to produce and export up to the level of quota, Vos and Sánchez (2006) show that there could be a more significant impact on the economy and reduce the poverty incidence by an additional 1 percentage point per annum.²⁰ In this case, however, an important share of the workers would need to shift into the garments industry and this sector would replace agro-exports as the mainstay of the economy. However, reliance on maquila industries will make the country vulnerable to shifts in the global market for textiles and may not be a sustainable source of job creation over time given strong international competition, as also Honduras has discovered.

Therefore, it is not evident that CAFTA represents an opportunity to engender a pro-poor growth process. Just as in the Honduran case, the main benefits do not automatically reach the poorest and the expected positive outcomes will be at most very modest. The Nicaraguan Government is aware of the problem of low-productivity in agriculture, particularly concerning sensitive products, and of the need of enhancing competitiveness. Indeed, growth and competitiveness are the pillars of both the original PRSP (the Strengthened Strategy of Reconstruction, Economic Growth and Poverty Reduction – ERCERP) and the National Development Plan (NDP). An obstacle to the analysis of the pro-poor nature of the suggested strategies is that apparently each plan reflects a different approach to economic growth. ERCERP pays more attention to redistributive issues, while the Operational NDP emphasizes growth *per se*. Under the current administration, the NDP finds more resonance, being also called ERCERP-II. For

²⁰ The estimated impact of CAFTA is based on simulations using a dynamic computable general equilibrium model for Nicaragua developed by Vos and Sánchez (2006).

the moment, however, it only consists of a plan, lacking any operational status. None of the plans approaches the concept of pro-poor growth in a broad sense, which poses another difficulty to our evaluation.

Investments in infrastructure may foster competitiveness in the country, but this is not an instant effect and would rather require prior financing, probably funded by external resources, leading once again to unsustainable levels of indebtedness. The development of tourism may contribute to the creation of new jobs, but it is likely that it would benefit skilled workers rather than the poor. Rural development could stimulate pro-poor agricultural development if managed to tackle the problem of land distribution. If no adequate answer is provided to the issues of land tenure and access to credit (and the NDP does not present any clear solution in this sense), it may be that the rural development plan will mainly benefit large-scale farmers and that agricultural modernization will imply the impoverishment of the majority of peasants.

8.5 Effective Redistribution Strategies Necessary

One would obviously prefer being more optimistic and believe that all different NDP pillars would yield synergies towards pro-poor growth. That is, the investments in infrastructure and trade integration would effectively manage to boost competitiveness, attract massive new foreign direct investments and generate employment, and at the same time, investments in human capital, rural development and the ambitions related to tourism would reinforce the economic growth. Nevertheless, for such things to happen, many political and global economic factors would have to concur without further adversities. Bearing in mind Nicaragua's recent history, such expectations would seem rather optimistic.

The main task to be faced by policy-makers now consists in making the NDP plans operational, constructing contingency scenarios in order to respond to adverse shocks, as well as paying more attention to redistribution strategies. As it was shown, if effective redistribution does not happen, the Nicaraguan economy will have to grow at a much quicker pace than its historical potential has proved possible. However, if effective redistribution occurs, the same goal could be achieved with a much more modest growth.

Conclusions and Recommendations

CHAPTER 9

The PRSP process in the three countries continues to face a number of challenges, as detailed in the previous annual country reports (ISS 2003a-d). These challenges originate from weaknesses that emerged early on in the process: the limited time that was devoted to the design of the programs, the feeble estimates of the cost of the process, the weak transmission channels between the design and implementation of the strategy, and the absence of dialogue regarding sensitive issues. These factors have contributed to a limited sense of ownership and actual participation in the strategy, thereby weakening its political support. This hampers the continuity of the process.

Further, the donor conditionality related to the PRSP has spread to other spheres beyond traditional economic indicators, increasing the tension and reducing the effectiveness of partnership between certain donors and countries. Thus, the country ownership of the PRSP is in question, as are the strategy's chances of political survival during electoral change.

In their short existence, the PRSPs have undergone many changes. This could be a good sign, an indication of a dynamic process of policy formulation, however in fact modifications have taken the form of 'National Development Plans' whose connection with the original PRSP is not very clear.

Nicaragua and Honduras have managed to build consensus (although it may be temporary) to fulfill formal requirements for qualification for funding, but have not been able to meet the targets for economic growth.

Nicaragua and Bolivia have not been able to gain acceptance for PRSP programmes and policy action in a reformed budgeting process, ensuring enough of resources for anti-poverty programs. Such acceptance would have allowed more protection from political change.

Only Honduras has managed to pass legislation that guarantees consistency between the PRSP and the national budget, although the effectiveness of this measure is still to be observed in practice.

As to common critical spheres of progress made in the PRSP process in the three countries, the conclusion is that broad-based participation has not lived up to expectations. In fact, civil society has lost space vis-à-vis the new agendas of the second generation PRSPs. Attention to cross-cutting issues such as gender has weakened even further

9.1 Weak processes

The PRSP process in the three countries is still very weak. In the case of Nicaragua after the HIPC culmination point, what are the prospects for the country to avoid falling in the debt cycle again? In Bolivia, where the voice of civil society is strong, the National Dialogue has focused on sensitive topics that had not been discussed in the original PRSP. However, a more coordinated agenda could not be achieved in 2004, while the fragile political situation limited the continuity of PRSP execution. Honduras was to go through election campaigns in 2005 and the revised PRSP was developed without generating broad social consensus. It should not be surprising, therefore, that the PRSP would undergo another set of important changes in response to new demands and promises made during the election process. All of these elements of uncertainty and continuous change of plans make it very difficult to evaluate the PRSPs in terms of their outcomes. For now, all that is possible is to assess the *process* of strategy design and implementation.

9.1.1 Long-term approaches needed

Some donors still apply a short-term approach in the practice of macroeconomic policies, budgeting, monitoring and the provision of financing. Poverty reduction certainly demands economic stabilization, but it also requires far reaching changes to strengthen public-private partnerships and to generate capabilities, opportunities and security. Thus, short-term indicators only offer one dimension of the evaluation of progress.

The PRSPs of the three countries pay little attention the policy trade-offs that may emerge between the short and long-term objectives and also do not address the issue of gaining sufficient support from civil society for strategies to make them politically viable. Honduras and Nicaragua rely on enhanced competitiveness, but gains in this area depend on new investments in infrastructure and human capital with returns that can only

be obtained in the medium run. The PRSPs assume, in contrast, that such gains will come more or less instantaneously. This lack of attention to inter-temporal trade-offs, creates doubts as to whether the financing of these investments will be sustainable and whether the existing political support for these strategies will not quickly evaporate as no results become visible in the short run.

Economic volatility and vulnerability are important sources of risk for the pro-poor outcomes of these strategies. By enhancing competitiveness, Nicaragua and Bolivia expect to diversify their exports and reduce their vulnerability to external shocks. As already mentioned, tangible results are unlikely to show in the short run. In addition, both countries aim at strengthening (new) agricultural exports and *maquila* industries which are no less sensitive to world market fluctuations than traditional exports. For Bolivia this risk is even greater as it plans to collect its revenues from a single product, natural gas, sensitive to highly volatile world oil prices. This situation calls for the creation of an efficient stabilization fund, but such a fund is yet to be created.

It is noteworthy and worrisome at the same time that the three PRSPs pay so little attention to mechanisms that could deal with the volatility of output growth and government revenues, and also soften the impact of such volatility on resources to finance the PRSP and on the income of the poor. Consequently, foreign aid can play an important role in fostering the provision of stable and sustained financing, as required by the long-term approach that should predominate in PRSP operational plans.

9.1.2 Donor coordination and conditionality

Donors have made some progress with improved donor coordination and more effective aid provision. These positive steps are mainly organizational. Donors are supporting round tables (*mesas sectoriales*) as a means of strengthening dialogue on the coordination of the sector programs that are part of the PRSP. In addition, steps have been taken towards more program aid, budget support, and the establishment of Joint Financing Agreements among a large group of donors – all in support of the poverty reduction strategies. Nevertheless, a good number of round tables are not functioning well due to lack of political support or organizational capacity on behalf of the recipient government.

Conditionality related to foreign financing still remains a problem. Original sins prevail. Firstly, an agreement on short-term macroeconomic policies with the IMF remains a precondition for obtaining support from other donors. Secondly, most donors preserve their strong inclination towards ‘micromanaging’ aid conditionality and monitor a detailed list of

policies and reforms that governments should follow. Given the weak governance and credibility of the PRSP countries, this tendency to impose specific policy conditions may seem reasonable in order to ensure program effectiveness. On the other hand, the same donor behaviour tends to erode government commitment and the sense of PRSP ownership by civil society, .

Excessive involvement of donors in policy formulation can be counter-productive. To avoid such an outcome, changes to the current approach move in the following direction:

- Donors should evaluate if recipient countries are *implementing a more or less coherent program for poverty reduction*, and not if they have *detailed and comprehensive plans* to reduce poverty;
- Donors should reconsider the primordial role of typically short-term macroeconomic policies and of the IMF as the catalyst for all other aid flows in support of the PRSP;
- The PRSPs themselves should be more concrete (not necessarily more comprehensive) in detailing strategies for poverty reduction and indicating how proposed actions are expected to meet the Millennium Development Goals. They should establish a solid commitment by governments and donors in terms of the provision of financing, moving away from national plans that satisfy donor requirements only;
- Donors who choose to provide budget support according to the considerations above should do so using joint and multi-annual financing schemes (with one set of procedures and conditions);
- Donors should essentially focus their dialogue with governments on improved public financial management, especially as regards enhancing budgeting and accounting processes (towards an MTEF and result-oriented budgeting). As existing institutional capacity is weak and reforming budget procedures is cumbersome, a gradual approach along this path would be recommended.

9.2 Financing: Lack of stability and the threat of debt insolvency

One of the problems identified in these three countries is the lack of stability in financing, in part due to the absence of an operative multi-annual framework. Another reason is that IMF financing tends to be pro-cyclical. When economic performance weakens and there are delays in the adoption of the “correct economic policies”, disbursements are suspended or postponed until certain criteria are met, as in the case of Bolivia and Honduras. This is due to the fact that there are no clear guidelines of how the IMF should proceed with countries that have governance problems, but that are giving positive signs of implementing policies that favour the poor. Since the IMF is a catalyser of resources, other financing is immediately affected. As a result, short-term macroeconomic performance overrides the longer-term financing needs of the poverty reduction strategy in the conditions set by donors. Donors should therefore evaluate under which circumstances monitoring should go beyond macroeconomic criteria and be extended to poverty reduction processes.

Once countries reach the culmination point in the HIPC framework, this does not imply that the country’s solvency problems are over. When it comes to funding poverty reduction strategies donors have no defined preference for donations or loans. This is an issue that still needs to be debated, taking into account the specific poverty situation and growth capacity of each country. Both Nicaragua and Bolivia have reached their culmination points in the HIPC initiative, however the threat of debt insolvency has not disappeared as external borrowing continues to be an important source of financing in countries proposing Second Generation PRSPs.

9.3 Allocation of aid

9.3.1 Need for clearer guidelines

There is also uncertainty as to how to proceed with countries that have marginalized the PRSPs to the outskirts of the broader national policy agenda, as has occurred in Bolivia as well as countries that have failed to generate participation in the PRSP as in Honduras in 2003. It appears that sticking to an agreed PRSP is not a requirement for continued financing by donors such as the World Bank and the IDB. Official lending and aid to Bolivia kept flowing despite the fact that the status of the PRSP was in question, even from the country’s own authorities. In order to reduce the impact of the political crisis that affected the country, in 2003 the World Bank provided Bolivia with a *Social Safety Net Structural Adjustment Credit* to protect the budgets of health, education and targeted social safety nets,

as well as social services in remote poor areas. In January 2004, Bolivia also received financing through a *Social Sector Programmatic Structural Adjustment Credit* (SSPSAC) in order to support programs designed to meet the Millennium Development Goals. This flexibility can be beneficial for the country as long as there is explicit monitoring and accountability in the use of funding.

For aid to be more efficiently allocated in the PRSP context, donors and HIPC governments will need to agree on clearly defined guidelines. Some of these have already been mentioned in Chapter 2 on donor coordination.

9.3.2 The need for multi-annual programming

The strategies propose long-run economic reforms. As indicated, countries continue to be highly vulnerable to external shocks in the short and medium-run. Economic instability and uncertainty in financing prospects are important risks that could work counter to the PRSP objectives and lead to the adoption of policies with short-term effects. In this sense, multi-annual programming of external financial support seems to be required in order to provide governments with the necessary buffer to avoid economic volatility affecting budgets for the implementation of poverty reduction programmes.

Part of this multi-annual programming of aid could take the form of a financial insurance policy that would cover the above-mentioned macroeconomic risks. This proposal will not be elaborated here, but it is understood that new options need to be presented in order to reform the existing PRGF and PRSC. Multi-annual programming could make the conditions for accessing these credits more flexible.

The implementation of multi-annual programming under HIPC-II and PRSPs was thought to be able to provide

- (i) fiscal relief,
- (ii) protection of social expenditure related to poverty reduction, and
- (iii) additional financing for social expenditure.

Although, in practice, this has not been the case, recent initiatives favouring budget support and joint financial agreements by donors are signs in the right direction. Governments for their part should be also more decisive in their transition towards multi-annual and medium-term (MTEF)

programming and budgeting according to the PRSP guidelines. In this framework donors would need to rely less on conditionalities based on immediate results and rely more on procedures that are effectively leading to poverty reduction in the long term. Obviously, it will not be easy to get all donors to agree on the targeting to be adopted and the conditionalities that will trigger disbursements.

9.4 Comparison of pro-poor growth strategies

9.4.1 Lack of a pro-poor perspective

To grow or to redistribute? Is it possible to do both? In the three countries the idea of pro-poor growth is still very much an illusion. There is no consensus about what it is, neither is it a central topic in public policy debates. Thus, in none of the three countries is there consensus about which pro-poor growth policies seem to be the best fit to face this challenge. One initial problem is that there is no clear consensus as to what pro-poor growth means, consequently there is no clear vision on how to include pro-poor growth in the PRSPs.

The initial growth strategy, as proposed in the PRSPs, has changed in the three countries as these policies have been revised. Since growth has been modest in the three countries, emphasis has now turned to economic growth. Redistribution through public expenditure has thus been postponed to the longer run.

What is more, second-generation strategies in Honduras and Nicaragua were not specifically designed to combat poverty. They actually addressed the question of how to achieve higher economic growth. In both countries emphasis is placed on increased competitiveness and gains from trade in regional and world markets. Poverty reduction strategies have been made almost totally dependent on achieving a higher aggregate economic growth target. In Bolivia almost all hope for future growth is based on gas exploitation and on the use of its revenues to invest in the capabilities of the population and in poverty reduction in the long term.

Thus, there is a “pro-growth” bias, rather than a particularly “pro-poor” perspective.

9.4.2 Land tenure issue should be prioritized

Poverty in Latin America has two different faces, serious in densely populated urban areas but more alarming in rural areas where it particularly affects women.

How to foster the productive activities of the poor? One common element in the three strategies is that they all place considerable emphasis on rural

development and the importance of dealing with land distribution and property rights in favour of the poor.

However, almost no progress can be reported in any of the three countries in this field.

In Bolivia, agro-industrial production chains could generate income for the rural poor, but in practice incentives are biased towards modern export farming and the lack of access to land for poor people will likely be decisive in excluding them from the gains generated by these rural development policies. Moreover, the lack of access to land for the poor will likely be decisive in excluding them from the benefiting from these rural development policies.

In Honduras and Nicaragua this bias favouring modern crop production is even stronger (at least in terms of policy intentions) leaving incentives for the development of off-farm activities in rural sectors as an alternative which has not been sufficiently explored in the PRSPs. Possibilities of off-farm employment generation are limited to programmes that barely reach the rural poor and there are significant challenges to solving the land problem, similar to what has happened in Bolivia. Hence, the PRSP of the three countries should include the land tenure issue as a priority and clearly identify mechanisms to include the poor in land reform.

9.4.3 The budgeting framework

How to make donor conditionality fit a pro-poor strategy? As mentioned above, governments should resolutely move towards multi-annual and medium-term budgeting frameworks (MTEF) consistent with the PRSP guidelines. If poverty reduction strategies were to build on such an expenditure framework, donors would no longer need to impose specific policy conditionality, but could focus on the monitoring of the use of resources as well as policy impacts on PRSP targets.

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Notes on Authors

ROB VOS is Director of Development Policy and Analysis and chief economist at the Department of Economic and Social Affairs of the United Nations.

At the time when this study was written he was Professor of Finance and Development at the Institute of Social Studies in The Hague and Professor of Development Economics at the Free University Amsterdam. He was also the Coordinator of the Poverty Reduction Strategies Evaluation Team in Latin America, for which the present study was commissioned. Previously, he was the Deputy Rector of the Institute of Social Studies and worked as senior economist at the Inter-American Development Bank.

Professor Vos has worked as a policy advisor to governments and other agencies in Africa, Asia and Latin America. He has published widely on issues of finance and development, macroeconomic adjustment policies, trade liberalization, poverty and income distribution.

His most recent, co-authored book – *Who gains from Free Trade? Export-led Growth and Poverty in Latin America* – will be published by Routledge in 2006. He is currently coordinating a study on feasible development strategies for the achievement of Millennium Development Goals using economy-wide country models for eighteen Latin American countries.

MARITZA CABEZAS, M.Sc. in Development Economics (U.S.A.) and in Public Finance (France) is currently working with emerging markets at the Nederlandsche Bank (The Netherlands).

She previously worked at The Institute of Social Studies in The Hague in a project evaluating poverty reduction strategies in Bolivia, Honduras and Nicaragua.

Her career began at the Central Bank of Ecuador, where she was a specialist in macroeconomic policy and programming. For the last ten years she has been involved in development issues, particularly concerning Latin America.

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Acronyms

BS	Budget Support
CAFTA	Central American Free Trade Agreement
CC	<i>Consejo Consultivo Honduras/Consultative Council</i>
CEPAL	<i>Comisión Económica para América Latina y el Caribe/Economic Commission for Latin America and the Caribbean</i>
CONADES	<i>Consejo Nacional de Desarrollo Nicaragua/National Development Council</i>
CONPES	<i>Consejo Nacional de Planificación Económica y Social/National Council of Economic and Social Planning</i>
DFID	Department For International Development (United Kingdom)
EAP	Economically Active Population
EBRP	<i>Estrategia Boliviana de Reducción de la Pobreza/ Bolivian Poverty Reduction Strategy</i>
ENDAR	<i>Estrategia Nacional de Desarrollo Agropecuario y Rural/National Strategy of Agricultural and Rural Development</i>
ERCERP	<i>Estrategia Reforzada del Crecimiento Económico y la Reducción de la Pobreza Nicaragua/Strengthened Strategy of Reconstruction, Economic Growth and Poverty Reduction</i>
FDI	Foreign Direct Investment
FRP	<i>Fondo de Reducción de Pobreza/ Poverty Reduction Fund</i>
G17	Group of Seventeen
GC	<i>Grupo Consultivo Bolivia/Consultative Group</i>
GDP	Gross Domestic Product
GGG	Good Governance Group (Nicaragua)
GIC	Growth Incidence Curve
HIPC	Heavily Indebted Poor Countries
IDB	Inter-American Development Bank
INAM	<i>Instituto Nacional de la Mujer/Women National Institute</i>

ISS	Institute of Social Studies
IMF	International Monetary Fund
ISPRS	Information System of the Poverty Reduction Strategy
JFA	Joint Financing Agreement
JSA	Joint Staff Assessment Reports
KfW	<i>KfW Entwicklungsbank</i> /German Development Bank
MCA	Millennium Challenge Account
MDG:S	Millennium Development Goals
MS	<i>Mesa Sectorial</i> /Roundtable
MTEF	Medium-Term Expenditure Framework
NDP	National Development Plan (Nicaragua)
NGO	Non-Governmental Organization
PEGR	Poverty Equivalent Growth Rate
PGC	Poverty Growth Curve
PRGF	Poverty Reduction and Growth Facility
PRSPS	Poverty Reduction Strategy Papers
PRSC	Poverty Reduction Support Credit
PSIA	Poverty and Social Impact Analysis
ROB	Result-Oriented Budgeting
Sida	Swedish International Development Agency
SME	Small and Medium Enterprises
SS	Sector-wide Support
SSPSAC	Social Sector Programmatic Structural Adjustment Credit
SWAP	Sector-Wide Approach
UNDP	United Nations Development Programme
WB	World Bank

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ROB VOS AND MARITZA CABEZAS

Rob Vos is Director of Development Policy and Analysis and chief economist at the Department of Economic and Social Affairs of the United Nations. At the time when this study was written he was Professor of Finance and Development at the Institute of Social Studies in The Hague and Professor of Development Economics at the Free University, Amsterdam.

Maritza Cabezas, M.Sc. in Development Economics and in Public Finance, is currently working with emerging markets at the Nederlandsche Bank. She previously worked at the Institute of Social Studies in The Hague in a project evaluating poverty reduction strategies in Bolivia, Honduras and Nicaragua.

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Swedish International Development Cooperation Agency
Address: SE-105 25 Stockholm, Sweden.
Visiting address: Sveavägen 20, Stockholm.
Tel +46 8 698 50 00, e-mail: sida@sida.se
www.sida.se