



JANUARY 2008 • GESKE DIJKSTRA, KRISTIN KOMIVES

Evaluation of the Poverty Reduction
Strategies in Latin America – 2007

The PRS Process and the Effectiveness of Aid



Preface

The PRS Process was a response to widespread concern about persistent and high levels of poverty in many developing countries and about the apparent ineffectiveness of aid in addressing this problem. At the center of the PRS Process was the idea of using a participatory process involving government officials and civil society to develop a national strategy for reducing poverty in each country. Donors committed to support these strategies with aid resources delivered as debt relief and programmatic aid. They also committed to align their aid programs with the national poverty reduction strategies.

The Swedish International Development Cooperation Agency (Sida) asked the Institute of Social Studies (ISS) in The Hague to conduct a study to monitor and evaluate the PRS processes in three countries of Latin America that are eligible for debt relief: Bolivia, Honduras, and Nicaragua. The study was conducted over five years, beginning in 2003. Since 2003, the PRS process has taken different paths in the three countries. For example, while the PRS continues to be an important document in Honduras, in Bolivia no one talks about the PRS process anymore. Adapting to these changes, the annual reports have touched on topics beyond the strict confines of the PRS process, also addressing issues of concern for poverty reduction more generally.

Five reports are published each year: three country reports about recent developments in the PRS process, one regional report that presents a comparative analysis, and one thematic report on a topic chosen in consultation with Sida each year. The annual reports and the executive summaries in English and Spanish are available on the ISS website (www.iss.nl/prsp). The ISS website also includes background reports about gender, rural development, and education, which contributed to the analysis in the annual country reports.

All of the reports are based on data analysis, a review of available literature, and interviews with national and local-level actors involved in the PRS process. The ISS team has had complete independence in the process of designing, implementing, and financing the studies. The opinions and conclusions expressed in the reports are those of the authors and are not necessarily the opinions and conclusions of Sida.

The 2007 reports, as the final reports in this series, are somewhat different from the reports of previous years, in which recent developments in the PRS process were presented in great detail. The 2007 country reports and regional report present a longer-term view of the

PRS experience, and thus take into consideration the entire PRS period as well as the years preceding the start of the PRS Process. The goal has been to draw lessons and identify trends in foreign aid during the last 12 years. The thematic report also takes a longer-term view on rural development policies in each country and, as a result, does not discuss in detail all of the most recent developments in this sector.

We hope that the 2007 reports will help provoke and deepen discussions about the limited impact of the PRS process in the region and about how to better attack the problem of persistent poverty in Bolivia, Honduras, and Nicaragua.

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Project Coordinator
January 2008

This document was written by Geske Dijkstra and Kristin Komives, based on the country reports produced by Niek de Jong, João Guimarães, and Kees Bickart from the Institute of Social Studies, and by José Rafael del Cid (ESA Consultants—Honduras), Néstor Avendaño (CO-PADES-Nicaragua), and Juan Carlos Aguilar (SAXgr-Bolivia). The field work carried out in the three countries was essential input for the preparation of this document, and the authors are grateful to all those who agreed to be interviewed and to share their experiences on the topics covered in the country reports this year. The authors would also like to thank Rolando Vázquez, Fabián Eduardo Soria Merino, and Gilmar Zambrana Cruz from the ISS for their contributions. This document also benefited from the exchange of ideas that took place during the work-in-progress meetings held in The Hague in October 2007. The conclusions presented in this document, as well as any remaining errors, are entirely the responsibility of the authors.

Evaluation of Poverty Reduction Strategies in Latin America

Regional Report 2007

The PRS Process and the Effectiveness of Aid

A 5 Year Assessment of Experiences in Bolivia, Honduras and Nicaragua

Published by Sida 2008

Department for Latin America

Authors: Geske Dijkstra, Kristin Komives

Art. no.: SIDA37192en

ISBN: 91-586-8058-6

This publication can be downloaded/ordered from www.sida.se/publications

The Views and interpretations expressed in this report are the author's and do not necessarily reflect those of the Swedish International Development Cooperation Agency, Sida.



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Glossary

BSG	Budget Support Group
CAF	<i>Corporación Andina de Fomento/</i> Andean Development Corporation
CCERP	<i>Consejo Consultivo de la Estrategia de Reducción de Pobreza/</i> Consultative Council for the Poverty Reduction Strategy
CS	Civil Society
CEDLA	<i>Centro de Estudios para el Desarrollo Laboral y Agrario/</i> Center for Labor and Agricultural Development Studies
CNA	<i>Consejo Nacional Anti-corrupción/</i> National Anti-Corruption Council
CONPES	<i>Consejo Nacional de Planificación Económica y Social/</i> National Council for Social and Economic Planning
DFID	Department for International Development
EBRP	<i>Estrategia Boliviana de Reducción de Pobreza/</i> Bolivian Poverty Reduction Strategy
EC	European Commission
ECLAC	Economic Commission for Latin America and the Caribbean
EFA	Education For All
G-16	Group of Sixteen
GDP	Gross Domestic Product
GNP	Gross National Product
GTZ	<i>Deutsch Gesellschaft für Technische Zusammenarbeit/</i> German Technical Cooperation
HIPC	Highly Indebted Poor Countries
IDB	Inter-American Development Bank
IFI	International Financial Institution
IMF	International Monetary Fund
INE	<i>Instituto Nacional de Estadísticas/</i> National Institute of Statistics
ISS	Institute of Social Studies
JICA	Japanese International Cooperation Agency
KfW	<i>Kreditanstalt für Wiederaufbau/</i> Reconstruction and Development Bank (German)
MAS	<i>Movimiento al Socialismo/</i> Movement to Socialism
MDF	Multilateral Debt Fund

MDG	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MNCS	<i>Mecanismo Nacional de Control Social/</i> National Mechanism of Social Control
NGO	Non-governmental Organization
OECD-DAC	Organization for Economic Cooperation and Development- Development Assistance Committee
PASE	<i>Sistema Nacional de Concertación y Participación/</i> National System for Coordination and Participation
PMAP	<i>Program Multi-anual de Apoyo Presupuestario/</i> Multi-annual Budget Support Program
POMA	<i>Programa Operativo Multi-Anual/</i> Multi-Annual Operational Plan
PRGF	Poverty Reduction and Growth Facility
PRP	Poverty Reduction Policies
PRS	Poverty Reduction Strategy
PRSC	Poverty Reduction Strategy Credit
PRSP	Poverty Reduction Strategy Paper
PSTAC	Public Sector Technical Assistance Credit
SIAFI	<i>Sistema de Administración Financiera Integrada/</i> Integrated System of Financial Administration
SIDA	Swedish International Development Agency
SIERP	<i>Sistema de Indicadores de la Estrategia de Reducción de Pobreza/</i> System of Indicators for the Poverty Reduction Strategy
SIGFA	<i>Sistema Integrado de Gestión Financiera y Auditorial/</i> Integrated Financial Management and Audit System
SIGMA	<i>Sistema Integrado de Gestión y Modernización Administrativa/</i> Integrated System of Administrative Management and Modernization
SINASID	<i>Sistema Nacional de Seguimiento a Indicadores de Desarrollo/</i> National System to Monitor Development Indicators
SISER	<i>Sistema de Seguimiento y Evaluación de la Gestión Pública por Resultados/</i> System for Monitoring and Evaluating Results-Based Public Management
SSPC	Social Sectors Programmatic Credit
SSPSAC	Social Sectors Programmatic Structural Adjustment Credit
TGN	<i>Tesoro General de la Nación/</i> General Treasury of the Nation
UDAPE	<i>Unidad de Análisis de Política Económica/</i> Economic Policy Analysis Unit
UNDP	United Nations Development Program
VIPFE	<i>Vice-ministerio de Inversión Pública y Financiamiento Externo/</i> Vice-ministry of Public Investment and External Financing
WB	World Bank

1. Introduction

The idea of “Poverty Reduction Strategies” (PRS) was introduced in the context of the 1999 Initiative for Highly Indebted Poor Countries. Countries were required to draft these strategies with the participation of civil society in order to qualify to receive debt relief under the HIPC Initiative. This was to ensure that the funds released for debt payments would be well utilized. At the same time, it was hoped that requiring the participation of the population in the process of drafting a PRS would ensure a greater sense of national ownership of poverty reduction policies and their implementation.

The PRS was also to be the basis for receiving any international aid. The hope was that by following the principles of ownership and partnership, the PRS would change the modalities of aid as well as the relationship between donors and receiving countries. Donors would not only follow the lead of governments and align their aid with these strategies, but would also give more aid in flexible modalities such as budget support and sectoral support.

The PRS processes coincided perfectly with donor aspirations to make aid more effective. Ideas like national ownership, comprehensive planning, and harmonization of aid introduced in the 1990s by the World Bank in its “Comprehensive Development Framework” are also found in the PRS. In recent years, efforts at improving the efficiency and effectiveness of aid were reinforced in the high level meetings in Rome (2003) and Paris (2005). In the Paris Declaration, more than 100 countries and official organizations agreed to promote five principles in their aid practices: national ownership, alignment, harmonization, results-based management, and mutual responsibility. These principles were made more concrete in the form of quantitative goals to be achieved by 2010. For example, one proposal was that 60% of all aid should be given in program modalities, in other words, in the form of budget support or sector support.

Consequently, the first objective of this year’s reports has been to analyze whether the PRS process has improved the efficiency and effectiveness of aid through the expected changes in the modalities for providing aid.

The *efficiency* of aid refers to the relationship between the inputs (the various aid modalities with their respective conditions and procedures) and their immediate effects (better governmental systems, better implementation of conditions, reduced transaction costs). It was hoped that

harmonization and alignment with the plans and procedures of the government would lead to greater efficiency by reducing transaction costs and a creating greater congruence between the priorities of the government and the requirements of the donors. The *effectiveness* of aid is the relationship between the immediate effects of aid and the intermediate or final results in relation to poverty, for example, pro-poor expenditures in the budget (intermediate result) and improvement in the Millennium Goals (final result).

In addition, as we are in the fifth and final year of this study, we are looking at the overall results of the PRS process in general. Has the PRS process and all of the donors' attention to poverty improved the commitment and the capacity of governments to reduce poverty? And finally, has this actually led to a reduction in poverty?

It is very difficult to establish a relationship between the PRS process, changes in aid modalities, and the efficiency and effectiveness of the aid. Many factors are involved, especially in the relationship between aid modalities and effectiveness. The empirical studies carried out in Bolivia, Honduras, and Nicaragua, summarized here, attempt to answer the following questions in this regard:

Has aid changed as a result of the PRS processes? What have the tendencies been between 1995 and 2006 in terms of quantity of aid, aid modalities, degree of alignment and harmonization, and conditions?

If changes have been made in the process of providing aid, is there any evidence that the aid is more efficient now?

What has happened in terms of the commitment and capacity of governments to actually reduce poverty? If there have been improvements, to what extent can they be attributed to the PRS process?

What is happening with poverty?

Statistical information and interviews with the people involved have been the basis for answering these questions. After studying the countries intensively for five years, we are in a good position to be able to answer the qualitative questions about how the PRS process has contributed to changes in aid and in the commitment and capacity of governments to reduce poverty.

This regional report presents a summary of the results in the three countries and puts them in the context of the changes in aid worldwide. It also presents a summary of empirical studies that have already been conducted on the effects of program modalities on the efficiency and effectiveness of aid. In this way, it is possible to reach stronger conclusions about the possible effects of future changes in aid modalities in the three countries.

Chapter Two looks at whether the PRS processes and the ideas for improving aid efficiency and effectiveness that began to emerge in the 1990s have really changed international aid overall. Chapter Three summarizes the debate on the effectiveness of aid in general and the presumed benefits of program support in specific. It also reviews current knowledge about the effects of program aid (budget support and sectoral approaches), and in particular, about the effects on using and reinforcing government systems, reducing transaction costs, reducing other costs of aid, and seeking greater effectiveness.

Chapter Four summarizes the changes in aid in the three countries and analyzes the extent to which these changes are related to the PRS processes. Chapter Five analyzes the effects of these changes and, in particular, the effects of program support and sectoral approaches on reinforcing government systems, on the ownership and implementation

of aid conditions, and on the effectiveness of aid in general. Chapter Six looks at the general results of the PRS process in the three countries: has it led to greater commitment and greater national capacity to reduce poverty? And has it, indeed, reduced poverty?

2. Changes in International Aid

2.1 Introduction

Around the year 2000, when the Poverty Reduction Strategy (PRS) instrument was first being introduced, a major change was being made in policies for foreign aid, at least at the level of discourse. This chapter attempts to analyze the extent to which aid has changed in practice. It will look at changes in the following areas:

- Volume
- Allocation by sector: social sectors versus productive sectors and economic infrastructure
- Modality: percentage of program support
- Volatility
- Selectivity with regard to receiving countries: according to poverty and policy
- Conditionality and ownership
- Alignment and harmonization

Before presenting the results, the following section summarizes the changes made and the origin of these changes.

2.2 Changes in Aid and their Origins

Changes made in the architecture of aid around the year 2000 include a greater emphasis on poverty reduction, as reflected in the adoption of the Millennium Goals; the beginning of the HIPC Initiative; the introduction of the PRS with national ownership and participation of civil society; the authorization of more budget support instead of support for specific projects; and a change in the name of adjustment loans (ESAF) to loans for growth and poverty reduction (PRGF). All of these changes can be considered a response to what appeared to be failures in the previous architecture.

In the latter half of the 1990s, international aid had decreased and there were growing doubts about the effectiveness of aid. Poverty had not declined, and many poor countries were suffering from having to make high payments to service their foreign debts. The academic debate about the effectiveness of aid was intense. On the one hand, there was growing discontent over the World Bank and IMF structural adjustment pro-

grams of the 1980s and 1990s. Doubts existed about effects of these programs on growth; their impact on social indicators and on poverty; and the effects of the conditionality they imposed. It was concluded that countries do not implement reforms unless there is national ownership of these programs. On the other hand, there was also a great deal of criticism of the modality of aid that was still dominant – that of project support. Projects are not able to show sustainable results if they do not have the firm underpinning of local commitment and appropriate macroeconomic policies. Furthermore, the existence of multiple projects funded by multiple donors – each with its own requirements – tended to undermine local capacity for planning, management, and monitoring.

Figure 2.1. Changes in International Aid around the Year 2000 and the Factors that Led to Them.

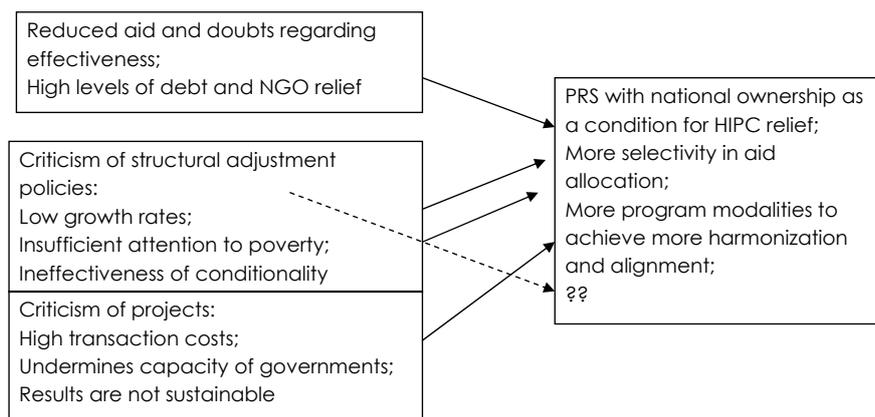


Figure 2.1 provides a summary of the possible factors behind the changes, classified by type of factor. The PRS was meant to resolve many of the problems that existed in aid: the lack of comprehensive long-term strategies, the lack of national ownership, the lack of attention to poverty, and the lack of attention to results. It was also meant to be an instrument that would allow donors to reach greater degrees of alignment and harmonization. On the basis of a PRS, multilateral donors would be able to give their policy-based loans (PRGF, PRSC etc.) and bilateral donors would give more program support. The program support could be different from the previous adjustment programs because now the conditions could be based on the PRS. Ownership of the PRS would ensure the implementation of the conditions. Governments with no intentions of reducing poverty – in other words governments without a PRS – would no longer receive aid, due to the principles of selectivity. In summary, the PRS could be considered an “escape forward.” With a single instrument, many of the long-term problems of aid architecture would be resolved.

Further ahead, we will look at whether the expected changes actually occurred. But for the moment, it is worth emphasizing that the PRS does not provide an answer to one of the criticisms of structural adjustment – the lack of macroeconomic results. The econometric studies of the 1990s were still unable to provide a consistent vision of the effects of these programs on inflation, balance of payments, and growth, even though negative effects predominate.¹ However, various authors have already expressed their doubt about the policies of liberalization, open econo-

¹ For a summary, see: Bird (2001).

mies, and privatization (“The Washington Consensus”) (Rodrik 1997; Stewart 1997; Stiglitz 1998; Rodrik 2001). The implementation of some reforms appears to have positive effects, but after a certain point, liberalization and privatization no longer lead to an increase in economic growth (White and Leavy 1999).

More recently, more sophisticated econometric studies (correcting for selection bias) confirmed these doubts by revealing the negative effects of IMF programs on economic growth. (Przeworski and Vreeland 2000; Barro and Lee 2005; Easterly 2005). Easterly (2005) also found that the countries that have had repeated adjusted programs do not have any better macroeconomic policies or more growth than other countries. Dreher separately analyzed the effects of programs’ conditionality on implementation and the effects of programs on economic growth and concluded that complying with conditions reduced the negative effects of the programs on growth, but did not eliminate them (Dreher 2006).

In response to the criticism, IMF programs are now called by another name (PRGF) in which the centrality of growth and poverty reduction is expressed. However, the IMF still plays a central role in the dialogue on the macroeconomic framework of economic policies and it doesn’t appear to have changed its conditionality much. (See also the paragraph on conditionality in the following section.)

2.3 Changes in Practice

In September 2007, 54 countries had a PRS approved by the World Bank and IMF Executive Boards. Of these, 14 now have two approved PRSs and one has three.² Another ten countries have an interim PRS. Many countries with PRSs also submitted Progress Reports, though no country managed to submit them annually according to the original intention. It is clear that the PRS instrument has been widely adopted. Now let’s see what has changed in international aid.

Volume

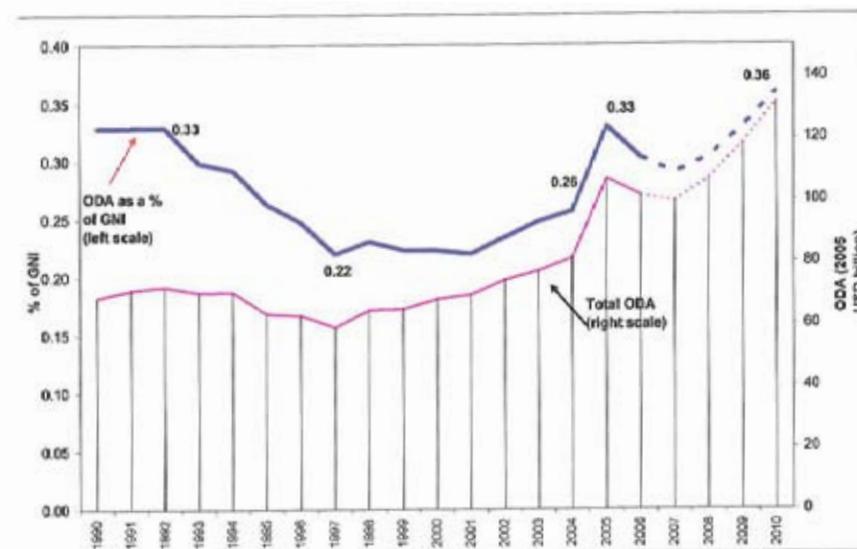
Aid has increased in volume during the 2000s, as well as in real terms (Figure 2.2). In terms of percentage of Gross National Product, aid decreased a great deal in the 1990s and began to grow again after 2001. A large part of the increase in recent years, however, is due to debt relief, which fits within the OECD’s definition of Official Development Assistance (ODA). For example, in 2005, more than \$22 billion in ODA was aimed at debt relief in Nigeria and Iraq. In 2006, a lower amount of aid for these two countries (14 billion) caused a decrease in the total volume of aid.

One issue that is discussed a great deal is whether debt relief has been granted in addition to “regular” aid or whether it has been a substitute for aid that would in any case have been provided. Various studies conclude that the countries that received debt relief did not experience a decline in their “normal” aid (Cohen et al. 2004; IEG 2006). What could have occurred, in fact, is that other less indebted countries may have received less aid after the implementation of the HIPC Initiative. The countries that reached the completion point for HIPC automatically benefited also from the MDRI (Multilateral Debt Relief Initiative) through which all IMF, World Bank, and African Development Bank debts were cancelled (along with IDB debt beginning in 2007) if they were incurred before 2004 (in the case of the World Bank) or before 2005

² The fact that there are many more countries with PRS than countries that could qualify for the HIPC Initiative is due to the fact that the PRS is also a condition for the IMF’s PRGF.

(for all other institutions). Given that multilateral debt made up the largest share of their foreign debt, these 22 countries are currently experiencing very low levels of foreign debt service. However, 19 countries of the 40 countries that originally qualified for the HIPC Initiative³ have yet to comply with the strict conditions of the initiative and therefore do not qualify for the MDRI either. Of the HIPC countries located in Latin America and the Caribbean; Bolivia, Guyana, Honduras, and Nicaragua are enjoying all of the benefits of these initiatives, whereas Haiti just reached decision point (November 2006) (IDA and IMF 2007).

Figure 2.2. International Aid (Total ODA) 1990–2006, and projections of the DAC Secretariat for 2007–2010; in US\$ billions (right scale) and in% GNI (left scale).



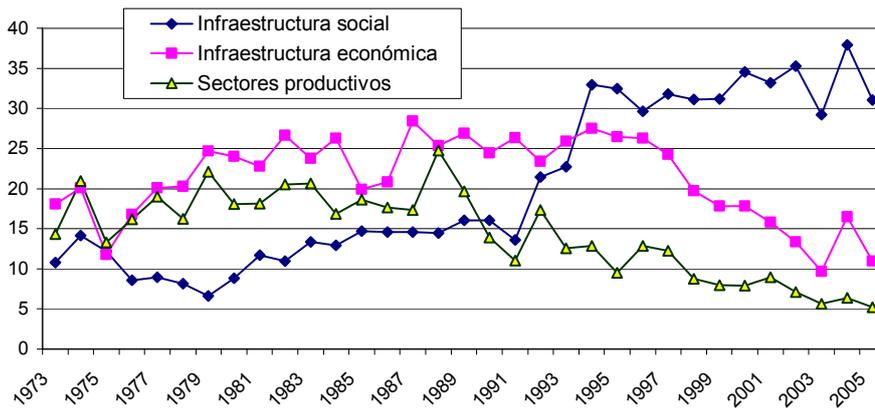
Source:
www.oecd.org/dac

Sectoral Allocation

In terms of the allocation of aid by sector, major changes are evident at the international level (Figure 2.3). The percentage of aid directed at social sectors has increased a great deal but this increase had already occurred during the 1992–1994 period. At the same time, the percentage directed at productive sectors has decreased. More recently, that is since 1997, the percentage of aid directed at economic infrastructure has also decreased quite a bit. One Dutch evaluation recently concluded that there is a relationship between the change towards a sectoral approach and the emphasis on social sectors: When donors were looking for two or three sectors in which to provide sectoral support, there were almost no national plans in place that were directed at production sectors. In addition, headquarters had a preference for social sectors (IOB 2006). Reviewing these figures, the change towards the social sectors has probably been too drastic. As other authors have also concluded, it is necessary to think about rebalancing and directing more aid to other sectors again (Killick and Foster 2007).

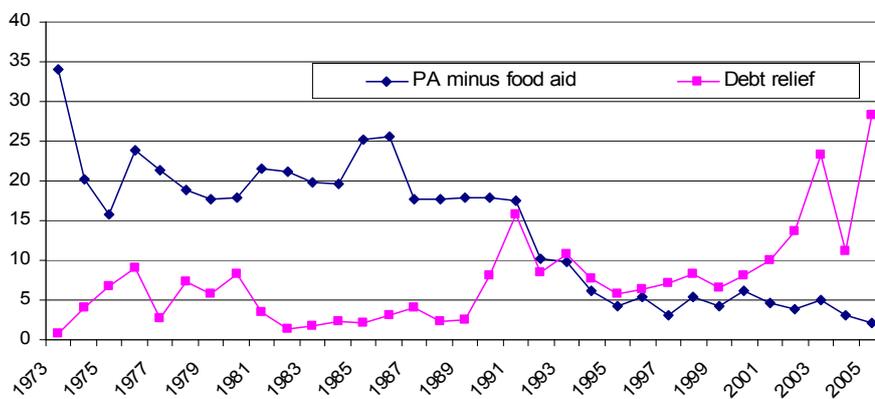
³ With the inclusion of Afghanistan after it reached its decision point in December 2006, there are now 41 countries.

Figure 2.3. Social Infrastructure, Economic Infrastructure, and Production Sectors as% of Total Aid, 1973–2005.



Source: OECD/DAC, CD-Rom.

Figure 2.4. Program Aid (Excluding Food Aid) and Debt Relief as% of Total Aid.



Source: OECD/DAC, CD-Rom.

Modality

Program Support is aid that is not directed at specific projects and which generally comes with political conditions. Historically, program support was balance of payments support (including import support tied to specific imports) and debt relief. Since 1999, the most common aid modality within program aid has been budget support, general or sectoral.⁴

It is very difficult to obtain statistical information on the volume of program support. OECD/DAC statistics have a category for program support, but the data is very imprecise because it is based on incomplete and varied information from donors. In addition, this category excludes sectoral budget support.⁵ In the 1980s, program aid was a much higher percent of total aid than in the following years (Figure 2.4). But during that decade, most program aid was in the form of balance of payments support and in practice it was often given as tied import support. For that reason, it was quite a popular aid modality among many donors. With the gradual liberalization of the foreign exchange markets, program aid

⁴ In practice, import support, balance of payments support, or debt relief could be converted into general budget support if the receiving country's government could sell the imported goods or currency and freely use the money earned; or freely use the money that was freed up by not having to service the debt. See White (1999).

⁵ Officially (according to the DAC definition), balance of payments support also includes food aid but it is kept as a separate category in DAC statistics, so it can be subtracted from the total program aid.

had to be given in the form of freely available money, and so the relative quantities decreased. It is surprising, however, that the negative tendency has continued into the 2000s, in spite of the discourse that program aid (budget support) would increase. Of course, it is possible that this is due to the fact that sectoral support is not included in these figures for program aid.

Another source of information for establishing the volume of program aid, at least for African countries, is the internet site of the Strategic Partnership with Africa (SPA), in which many countries participate. Molenaers and Renard used this information (Molenaers and Renard 2007) in a survey of 16 countries showing that the amount of budget support in 2004 varied between US \$25 million (Cape Verde) and US\$420 million (Tanzania). The average amount given is US\$ 200 million. On average, these 16 countries received 5.4% of their GDP in the form of general budget support. This varied between 1% (Senegal) and almost 13% (Rwanda). Compared with tax revenues, which averaged 16.8%, these are very high figures (Molenaers and Renard 2007).⁶

Volatility

One of the risks of giving more budget support is that it increases volatility. For a donor, it is easier to end this kind of aid than to end project aid. With projects, the donor tends to be more concerned about investments that have already been made. In addition, conditionality for budget aid is generally broader and more political in nature than the conditionality that accompanies projects, which means that the risk of non-compliance is also greater. From the perspective of the receiving country, on the other hand, the predictability of aid is even more important for budget support than it is for project support, which is why it becomes more urgent to reduce this volatility (Eifert and Gelb 2005).

It seems, however, that donor behavior has not (yet) improved in this area either. Bulir and Hamann conclude that the volatility of aid is higher than the volatility of tax income and is particularly high in countries that are highly dependent on aid. Furthermore, volatility has increased since the mid-1990s. Predictability – that is, the relationship between commitments and disbursements – improved in the 1980s but not in the 1990s, and it worsened between 1999 and 2001 when the average disbursement was only 50% of the commitment. An OECD/DAC survey of 34 receiving countries also found that in most of them, there is a large gap between commitments and disbursements of aid, which makes budgeting for development more difficult (OECD DAC 2007). In addition, only one fifth of the countries that went through an economic crisis benefited from increased aid during that period (Bulir and Hamann, 2005). This could be a negative effect of budget support, in so far as macroeconomic stability is maintained rigidly as condition for budget support.

Selectivity

According to rhetoric, selectivity in the allocation of aid by country would improve after 1999, both according to poverty and according to policies and governance. In other words, poorer countries and countries with better policies and better governance would receive more aid. Some studies have explicitly examined whether this change has occurred. Dollar

⁶ The 16 countries are: Benin, Burkina Faso, Cape Verde, Ethiopia, Ghana, Madagascar, Malawi, Mali, Mozambique, Nigeria, Rwanda, Senegal, Sierra Leone, Tanzania, Uganda, and Zambia.

and Levin looked at selectivity according to poverty (per capita income), governance (especially the rule of law), and democracy, comparing four periods: 1984–1989, 1990–1994, 1995–1999, and 2000–2003 (Dollar and Levin 2006). The title of this article (“The Increasing Selectivity of Foreign Aid”) gives the idea that selectivity has improved after 1999. In fact, this is only true for selectivity by rule of law, and this change had already taken place during the 1995–1999 period and was less significant during the 2000–2003 period. Furthermore, this change is only significant for the group of multilateral donors,⁷ not for bilateral donors. Nunnenkamp and Thiele compared the 1981–86 period with 1999–2002 and found that the portion of aid that went directly to the poorest fourth of countries had not increased. Neither had there been a change toward giving more support to the countries that exercise the strongest rule of law, control corruption better, or apply a policy of greater trade liberalization. According to this study, multilateral donors are not any better at selectivity than the bilateral donors. Among bilateral donors, colonial ties and trade interests are still very important in the allocation of aid (Nunnenkamp and Thiele 2006). It seems, therefore, that donors have not become more selective in their allocation of aid, but more recent data still need to be analyzed to see if there have been more changes since 2003.

Conditionality

According to the most optimistic expectations, conditionality was going to be less dominant and this would leave more space for national ownership. However, we have already mentioned previously that in order to fulfill the terms of the HIPC Initiative completion point, countries have to meet rigorous conditions: the macroeconomic conditions of the IMF, the requirement of writing a PRS with civil society participation, and the implementation of certain structural and social reforms, including the implementation of the PRS during at least one year. In practice, governments are also required to increase their pro-poor expenditures. Given this, it can be said that conditionality has increased in comparison with the years before 1999. In addition to the traditional conditionality (macroeconomic and structural reforms), now there are conditions related to the PRS and to pro-poor expenditures. Traditional conditionality has frequently impeded, and continues to impede, the ability to reach decision points and completion points (IDA and IMF 2007). Some potential HIPC countries also have problems drafting a PRS. But even in countries that have a PRS, the old problems of conditionality (limited implementation due to lack of ownership and doubts as to whether the recommended policies are appropriate) do not appear to have decreased.

The various studies that have been done on the PRS instrument, including the evaluations of the IFIs themselves, have revealed that strong tensions exist between the idea of national ownership and the PRS as a condition for debt relief or for IMF loans. (IEO 2004; OED 2004). The fact that a government has drawn up and presented a PRS still does not mean that it is committed to poverty reduction, and the same is true for the consulting requirements. Many governments only organize dialogue and participation processes in order to comply with the conditions and have not done much with the results of those consultations. It is not clear, therefore, that process-related conditionality (requiring participation) is any more successful than conditionality related to content. In practice, donors continue to have doubts about the content of PRSs

⁷ As well as for the World Bank (IDA) and the IMF (ESAF/PRGF) as individual donors.

even if they have been approved. The previously mentioned evaluations observe that strategies are not sufficiently concrete, that many PRSs put too much emphasis on social sectors at the cost of a strategy for promoting growth, and that they lack a good poverty diagnosis, as well as instruments for monitoring the strategy. In addition, many donors are not convinced that governments are committed to implementing poverty reduction policies. In this situation, while talk of ownership continues,⁸ in practice, donors perceive that conditionality continues to be necessary. It can also be concluded that conditionality continues to be necessary because the donors are not sufficiently strict on selectivity (Dijkstra 2006; Killick and Foster 2007).

It is still possible to believe that conditionality may have changed somewhat in nature by acknowledging the need for more government ownership. For example, conditions could be more “harmonic” and less “dissonant,” and they could include more goals and results instead of prescriptions for actions and policies (Molenaers and Renard 2007). This latter kind of conditionality gives governments more discretionary control and therefore more ownership. The European Commission (EC) explicitly attempts to apply this type of condition in its policy for providing budget support. However, an early evaluation of EC budget support concludes that most of the conditions are still measures and not results (Adam et al. 2004). Other indicators for evaluating the level of ownership are the number of conditions and the extent to which the conditions are based on the PRS (assuming there is a certain level of ownership of the PRS itself – which is not always true.) The Dutch evaluation of the sectoral approach concludes that the conditionality of all of the donors is still strong in quantitative terms and that there is limited national ownership of the sectoral plans and of aid management (IOB 2006).

EURODAD has studied World Bank and IMF conditions in 20 low-income countries (EURODAD 2006). These 20 countries have, or had, at least one approved PRS and had at least two (loan) programs with these institutions between 2000 and 2005. In other words, these countries are considered stable and they receive a lot of foreign aid. The study showed that the number of conditions is still very high (between 33 and 197 per World Bank loan in 2005) and has even grown during this period for World Bank loans. In the case of the IMF, the number of structural conditions has not decreased. The programs of both institutions frequently include conditions that require the privatization of public services or the liberalization of foreign trade. These are some of the more controversial conditions since it is not clear that they contribute to economic growth. Furthermore, many of the conditions were not based on the PRS. Finally, almost half of the IMF conditions and a quarter of the World Bank conditions took the form of “prior actions” (IMF) or “preconditions” (WB), so they had to be complied with before the loan funds were disbursed. According to the information presented in this EURODAD study, the nature and quantity of the conditions do not appear to reflect a high level of ownership. On the contrary, it seems that the WB and the IMF are continuing to try to impose their policies on the governments.

An independent evaluation of the IMF concludes that the existence of the PRS has not changed much in the work of the IMF. Official discourse on the centrality of poverty does not have an influence on the practice of negotiating the programs and so the conditions continue to be the same (IEO 2007).

⁸ For example, the Paris Declaration only discusses ownership and is “silent” on conditionality (Rogerson 2005).

Alignment and Harmonization

With the PRS, donors were not only going to align themselves with national plans, but aid was also going to go to national budgets, aligning itself with national systems of implementation, procurement, financial administration, and monitoring. In addition, to the extent possible, donors were going to coordinate among themselves.

In practice, several donors and organizations are not applying the Paris Declaration. For example, the United States has its Millennium Challenge Account (MCA) whose implementation is separate from the efforts of all other donors, including USAID. Vertical funds are another example in that they sometimes have their own units for planning, implementation, administration, and monitoring within the countries (Molenaers and Renard 2007). In general, it seems that there is much to do achieve alignment and harmonization (Killick and Foster 2007; OECD DAC 2007). These objectives have high priorities in the headquarters of aid agencies, at least at the level of rhetoric, but in practice and within the countries, the old practices, such as tied aid, technical assistance determined by donors, and the lack of coordination continue. Short term pressures (to comply with the procedures required by headquarters and disbursement pressures) prevent staff from investing in improving the effectiveness of the aid in the longer term. Alignment is also limited by weaknesses in the receiving countries, for example, weak systems for financial planning and management (OECD DAC 2007). On average, only 40% of aid to governments uses national systems for financial management and procurement. The number of official organizations providing aid only appears to have grown (Riddell 2007).

Conclusion

Has international aid changed due to the PRS processes? In general, any changes made do not appear to be very great. Table 2.1 summarizes the findings. The basic point appears to be that congruence does not always exist between donor preferences and the preferences of the receiving country. This entails a dilemma for donors: this congruence is most likely lacking in countries with high levels of poverty, so countries that need aid most. In this situation both sides want the flow of aid to continue and as a result, full ownership is impossible and forms of conditionality continue to be necessary.

Table 2.1. Changes in Aid since 2000

Dimension	Result
Volume	Has grown but mostly due to debt relief
Sectoral Allocation	More attention to social sectors but this has been true since the 1990s before the PRS
Modality: Budget Support	Official data is lacking but according to SPA data, it appears high in Africa.
Volatility	Has not decreased
Selectivity	Has not increased, at least not through 2003
Conditionality and Ownership	The PRS is an extra condition; Tension between the PRS as a condition and national ownership of the strategy; Traditional conditionality was not reduced and did not change in nature: Many structural conditions Many conditions regarding processes and not just results Many preconditions
Alignment and Harmonization	Very slow progress

3. The Relative Effectiveness of Budget Support

3.1. Introduction

According to the PRS principles of ownership and partnership, donors were going to provide more aid in the form of program modalities: that is, in general and sectoral budget support and in aid that would be part of a sector-wide approach. This intention was confirmed in the Paris Declaration of April 2005, with a specific goal that in the year 2010, 60% of all aid would be given in these modalities. It was assumed then that these modalities would improve the efficiency and effectiveness of aid as compared to the project support modality. Before analyzing the concrete results so far of the implementation of these modalities, we present here a brief summary of the debate around the effectiveness of aid in general and on the presumed advantages of program modalities in particular.

Econometric studies on the effectiveness of aid generally try to establish a relationship between the amount of Official Development Assistance (ODA) received (in% of GDP) and economic growth. In the equations used, aid is one of a series of variables that influence growth, along with initial GDP, education levels, openness of the economy (the absence of an overvalued exchange rate), investment, etc. The most recent studies control for the possible endogeneity of aid (for example, that aid may be caused by the lack of growth) by instrumenting it, using some independent variables that, together, determine the aid volume.

The results of these studies are very diverse and there are positive and negative findings. Many studies proved not to be robust. Tarp maintains that in the end, there are indeed robust and significant positive effects, but that they are not very great (Tarp 2006). According to Rajan and Subramanian, the only thing we know is that significant effects cannot be determined (Rajan and Subramanian 2005). The authors who do find positive and robust effects generally conclude that the effect lessens when the volume of aid increases; that is, there are diminishing returns to scale (Hansen and Tarp 2001; Clemens et al. 2004).⁹

⁹ When looking at the not very positive results of aid, one must take into account the fact that aid plays quite a small role as compared to other relationships between developed and developing countries. International markets do not offer equal opportunities to both rich and poor countries. While the wealthy countries, the donors, proclaim and prescribe the liberalization of international markets, they are not applying these measures to themselves in areas where they stand to lose, for example, in the agricultural goods market and in the labor market. Generally, the wealthier countries do not permit immigration, and developed countries pay a total of US\$300 billion annually (about three times the amount of ODA) in subsidies to their farmers, thereby blocking access to their markets and lowering international prices. We must also take into account that a large part of what is recorded as "aid" (ODA) is not spent in the poorest countries or used in the most efficient way for reducing poverty. As described in chapter 2, the allocation of aid is still determined in large part by the political and economic interests of the donors.

The effect of aid on economic growth is the net result of its costs and benefits. These costs and benefits have to be analyzed both in relation to the volume of aid (money) and in relation to the conditions or procedures tied to this money. The benefits of the money are that it stimulates positive effects on investments, on the productivity of the economy, or on aggregate demand in general, including consumption. In countries with large fiscal deficits, aid can also contribute to stabilization by reducing the need to seek loans from the Central Bank (which would have inflationary consequences) or from private markets. The benefits of policy conditions depend on whether or not they are implemented and on whether the content of the conditions are appropriate for the receiving country (promoting growth). Experiences have been varied, but both types of benefits can be questioned (Radelet 2006). If the conditions either do not lead to growth or actually reduce growth, the effect of the aid is reduced. Other conditions and procedures generally only increase costs, but may do so to a greater or a lesser degree. These are “transaction costs” which vary by modality.

The diminishing returns to scale could be due to decreasing benefits. If the volume of aid grows, the profitability of the additional projects or uses probably decreases. In other words, the capacity to absorb aid has limits. But perhaps it is even more likely that the costs of aid will increase. Given that the international community wants to increase aid, it is important to know what the potential costs of aid are and in what way they are related to the different aid modalities. In this context, aid is defined as ODA (Official Development Assistance), which means that it comes from official sources, is meant for development purposes (not military), and has a grant element of at least 25%.¹⁰

3.2. Potential Costs of Aid

The literature on the subject shows several kinds of potential costs of aid:¹¹

- Economic costs
- Political costs
- Institutional costs
- Administrative costs, or transaction costs

Some costs, especially the economic and political costs, are incurred in a more or less equal manner throughout all of the modalities of aid. It is believed that other costs, particularly the institutional and administrative costs, are greater for project aid than for program aid.

Potential economic costs include:

- “Dutch Disease”: Aid flows cause an overvaluation of the currency and thus limit exports. There is little evidence of this, however, and in many cases, efforts to avoid this disease lead to high interest rates with negative consequences for private investment (Serieux 2007);
- A reduction of tax income due to a lack of incentives to increase it (“fiscal response”);
- The volatility and unpredictability of aid brings fiscal costs such as sub-optimal expenditures, or costs of new loans to compensate an aid reduction.

¹⁰ This means it may include loans but only if they are on soft conditions (with a present value of total repayments of 75% of the nominal value or less). In practice, the grant element in ODA is much higher than 25% (about 90%, on average).

¹¹ Different authors use different classifications. This particular one was presented in Hubbard (2005).

Political costs have to do with the fact that the governments of receiving countries have to put a great deal of effort into being accountable to the donors. This weakens downward accountability systems, which limits development towards a modern democracy (Moss et al. 2006). The same effect also occurs in countries with many resources (“the resource curse”). But having abundant flows of foreign aid is not exactly the same as having currency flows that come from oil exports, for example.

On the one hand, donors generally support democratization and good governance by placing conditions or by providing technical assistance. The requirement that civil society participate in PRS processes is one example of many such conditions. However, these efforts have had little success and it has proved to be very difficult to impose or promote democracy or better governance from the outside (Kapur 2001; Kenny 2006; Molenaers and Renard 2007). On the other hand, donors’ actions can weaken democracy when they make it a condition that parliament “must pass” certain laws, for example, or when they continue to support dictators, incomplete or hybrid democracies (Cammack 2007). Donors frequently continue to provide support to countries with stable macro-economies and economic growth, even when there is a great deal of evidence of corruption, human rights violations, or violations of the freedom of the press. In these cases, it is possible that aid helps to facilitate and actively maintain relationships of clientelism and patronage and thus limits the ability to reach a more rational and bureaucratic Weberian state (Moss et al. 2006). There is also evidence that aid does not reduce corruption but, rather, stimulates it (Alesina and Weder 1999; Knack 2001).

Institutional costs come from a lack of alignment with national systems, which, in turn, tends to break down or weaken these systems. Generally, these costs are attributed to project aid and it is assumed that the problem can be resolved by providing budget support. The following issues are of concern in terms of the lack of donor alignment with national priorities, systems, and procedures:

- Projects are donor driven and, thus, not aligned with national priorities; they may even weaken national capacity for planning.
- Many projects are not included in national budgets, and if they are, they are frequently managed financially from accounts kept outside of the government so that Secretaries of Finance have no control over execution or accounting. In some cases, the ministries suddenly have more resources available than they budgeted for. In others, the resources envisaged do not materialize due to gaps between commitments and disbursements. This is also influenced by volatility and unpredictability. All of this leads to great discrepancies between what is budgeted and what is actually spent. It reduces fiscal discipline and reduces interest in making, implementing, and auditing budgets, thus weakening the budgeting and auditing process in general.
- Projects are frequently implemented in separate implementation units with better paid staff. This could improve efficiency in the implementation of the donors’ projects, but at the same time, it weakens the implementation of the other activities of the government because these units attract the most qualified staff. The consequences go beyond reducing the capacity of the government. All this demand for highly qualified staff in highly paid and interesting positions in the administration of aid, both official and non-governmental, also reduces the interest in working for the private sector or establishing a business (Moss et al. 2006).

- The separate systems for auditing, monitoring, and evaluating projects distort a comprehensive vision of budget execution and of efficiency and effectiveness in total government spending.

Administrative costs, or transaction costs, are necessary in any aid contract, but it is believed that these costs are higher due to the lack of coordination and harmonization between donors and because of the predominance of the project modality. Each donor has its own systems and procedures for each project: for selection, implementation, procurement, administration, auditing, monitoring, and evaluation. A large part of the government capacity must be involved in negotiating its projects with donors. This leads to high transaction costs both for the donor and for the receiving country.

The lack of harmonization among many donors, or the proliferation of donors, not only increases these transaction costs in the short run, but also has consequences in the medium term. In this respect, it is possible to talk about direct and indirect transaction costs due to the lack of harmonization (Acharya et al. 2006). In other words, the lack of harmonization increases the negative effects on bureaucratic capacity, or the institutional costs (Knack and Rahman 2004). In its great desire to guarantee the success of its own projects, the donor funds training programs (in and out of the country) for the local staff involved, which may improve capacities but also leads to the absence of staff on the job. These staff members may also come to have a personal interest in maintaining these projects in spite of the possible negative effects on development (Arndt 2000). Each donor only thinks of its own project, and no one takes responsibility for the operational expenses that everyone considers free resources. As a consequence, investments are frequently made that later prove to have no staff and no secured maintenance. Competition between donors can even lead to hiding information from other donors. In addition, the more donors there are, the less any of them feels responsible for the impact of all aid on the development of the country (Acharya et al. 2006).

3.3. Expected Costs and Benefits by Modality

In the late 1990s, many donors and receiving countries were convinced that institutional and administrative costs could be significantly reduced by changing the aid modality from project aid to general or sectoral budget support, or at least towards a sector-wide approach in which donors could coordinate their assistance (whether in the form of budget support, common funds, or projects) around a national sector-specific plan (See Table 3.1). In general or sectoral budget support, money is transferred to the treasury to be used freely. As a result, the aid automatically uses national systems for implementation, procurement, and for financial management and auditing. If budget support is coordinated among various donors – with coordinated political dialogue, monitoring, and disbursement procedures – proliferation costs would also be resolved. Ideally, and in line with the PRS approach, this modality is also based on national systems for planning, monitoring, and evaluation.

The sector-wide approach, or SWAp, had already been proposed in the early 1990s as a response to the problems of project aid. (Andersen 2000; World Bank Africa Region 2001) This modality improves alignment and harmonization since it attempts to coordinate the activities of

donors based on a government plan for a sector. But the sector-wide approach generally includes both common funds or budget support, and projects. Thus, not all participating donors are necessarily aligning themselves with the national systems of procurement, implementation, financial management, monitoring, and evaluation of the receiving country, nor is it necessary for them to harmonize their actions in these aspects.

Based on these characteristics, it is possible to sketch out the presumed costs and benefits of each modality in order to arrive at some conclusion about their efficiency and effectiveness (Table 3.2). According to institutional economics, transaction costs are the costs of establishing the contract, from setting it up (*ex ante*) to ensuring its execution (*ex post*). They include: i) information and search costs, ii) the costs of negotiation, and iii) the costs of monitoring and enforcement. For the agent in the contractual relationship, this third phase entails bonding costs (Eggertsson 1990; Hazeu 2000). It is presumed that all three costs are high in the case of project aid, especially because of the existence of multiple projects, that is, because of aid fragmentation.

Table 3.1. Aid Modalities: Their Expected Alignment to Various National Systems and Level of Harmonization

	Projects	Budget Support (General or Sectoral)	Sector-Wide Approach (SWAp)
Alignment with national plans	Partially	Yes	Yes
Use of national acquisition systems	No	Yes	Partially
Inclusion in the budget	Partially	Yes	Partially
Use of national financial management systems	Partially	Yes	Partially
Use of national auditing systems	No	Yes	Partially
Use of national systems for monitoring and evaluation	No	Partially	Partially
Harmonization among donors	No	Partially	Yes

Budget support based on a PRS should include the cost of producing the PRS itself,¹² the costs of verifying the preconditions for budget support, the costs of negotiating the matrices of policies and indicators among the donors and with the government, and the costs of monitoring and reporting on these policies and indicators. Much depends, as well, on the extent of coordination among the donors giving budget support and on the relative quantities of budget support and project aid. In the sector-wide approach, transaction costs also depend on the amount of aid included in the approach as compared to aid not included and on the level of alignment and harmonization among donors. It can be expected, however, that negotiation costs will have to increase in order to achieve a higher level of harmonization.

To the extent that budget support and the sector-wide approach use national systems, institutional costs are lower and it is even possible for

¹² Since it usually is a condition for budget support; and PRSs would probably not exist in the absence of donor conditionality.

there to be positive effects on the development of national systems. Ideally, budget support could also lower the political costs of aid. If donors request transparency in budgets and in budget execution, this may also help parliament and civil society to exercise better control over the government. In terms of the economic costs, there is not much difference between the modalities, with the exception of volatility. The volatility of budget support is greater than that of projects since it comes with more political and economic conditions. In addition, the costs of this volatility are probably greater due to the use of these resources, since they are not investments that can be temporarily suspended, but are frequently operating expenses like salaries.

As we mentioned earlier, the effects of policy conditionality depend on whether the conditions are complied with and on the content of the conditions. It is not possible to arrive at a general conclusion about the aid money spent on projects since it depends on the kind of project and the political circumstances of the country. The benefits of budget support and the sector-wide approach are also empirical questions, but it is even more difficult to establish the effects of these kinds of aid because the donor money is mixed in with the government's own resources so it is no longer possible to establish the effects of aid separately.

Table 3.2. Aid Modalities: Expected Costs and Benefits

	Projects	Budget Support	Sector-Wide Approach (SWAp)
Transaction Costs: information and selection	High	Low, but high if they include costs of drafting a PRS with participation, and the costs of verifying preconditions for budget support.	The costs of creating a sectoral plan and of verifying preconditions for a SWAp
Transaction Costs: negotiation	High	Medium: Is a PRS being used? Costs of negotiating the matrix of policies and indicators between donors and the government. ¿What is the level of coordination among donors?	Medium: Costs for achieving coordination: sectoral round tables and other meetings of groups of donors
Transaction Costs: monitoring and ensuring execution; and bonding costs	High	Medium: costs of monitoring and reporting systems What is the level of coordination?	Depends on aid modality
Institutional Effects	Negative	Possible positive effects	Possible positive effects
Political Effects	Negative	Depends: Is transparency increased? ¿Is it used by the parliament and by civil society?	Depends
Economic Costs: "Dutch Disease"	Equal		
Economic Costs: fiscal response	Equal		
Economic Costs: volatility and unpredictability	Low	High	Medium
Effects of policy conditionality	–	Depends on the execution and content of the conditions; can be positive or negative	Depends on the execution and content of the conditions; positive or negative
Benefits of the Money	Depends	Depends	Depends

3.4. Empirical Evidence

Though much has been said about the transaction costs of aid, few empirical studies have actually quantified these costs. A great deal of anecdotal information exists about the high transaction costs of project aid, but generally it is concluded that it is too difficult to measure them. For example, efforts to measure these costs in the receiving government by asking about the time they invested in managing foreign aid were not successful, basically because the government officials could not differentiate between that time and the time spent on other activities (Amis et al. 2005). The perception of these costs varies among the various actors (Brown et al. 2000).

Some authors measured the dispersion of donors or the proliferation of aid and used it as an approximation of the transaction costs. O'Connell and Soludo (2001) calculated the Herfindahl Index for the concentration of donors and found that the lowest concentration is found in Sub-Saharan Africa, with 0.13, followed by Latin America, and South Asia with 0.17. This means that Africa, Latin America, and South Asia are the regions with the greatest proliferation of donors. Acharya et al. (2006) found a positive relationship between donor proliferation (the inverse of the concentration) and aid fragmentation at the level of the receiving countries. That is to say that the most "proliferated" donors (those that disperse their aid among the greatest number of countries), were also the most present in the countries with high aid fragmentation.

Knack and Rahman (2004) were able to establish an empirical relationship between the proliferation of donors and a worsening in the quality of bureaucracy and governance in the receiving countries. A sample of 96 countries shows a significant negative relationship in the period from 1982–1991, and the relationship intensifies in a subsample of 30 African countries.

Studies on budget support or sectoral approaches have also had difficulties establishing transaction costs. In Bolivia it was observed that the effort to harmonize aid delayed disbursements, which then increased transaction costs for donors (Nickson 2005). Government officials from Mozambique also observed that negotiating time was drawn out when many requirements and preconditions were included before disbursement, for example, in the area of financial management (Batley 2005). Killick (2004) emphasizes that a large part of aid generally remains outside budget support, which is why aggregate transaction costs are still not decreasing. Transaction costs are not being reduced in the sector-wide approaches either since many parallel systems still exist. Part of the aid remains outside and there are separate meetings with the donors of the common fund, and with other donors (White 2007).

The institutional costs of program aid are reduced to the extent that they use national systems and coordinate among donors. In practice, however, national systems are not always used. With respect to planning, a national PRS is generally required, but in practice the PRS is not always used as the basis for the policy dialogue. In Mozambique, for example, another national socio-economic national plan was used and in other cases the debate proved to be focused on a policy matrix that is only partially related to the PRS (IDD and Associates 2006). In addition, it is possible to question the national ownership of many PRSs (See Chapter 2). In many sector-wide approaches, donors do not respect the ownership of the plan and engage in micromanagement. In Bangladesh, the introduction of this approach in health in the early 1980s led to the destruction of the national capacity for planning: donors began to create

the plans even though the country had done its own planning previously.¹³ There were also positive effects of this SWAp; it led to the adoption of the World Bank procurement system; first, for the health sector alone, and later for the whole government (White 2007).

According to the multi-donor evaluation of general budget support, this kind of budget support had positive institutional effects in some cases since it reinforced government capacities, especially in the area of public financial management. These positive effects were the result not only of using national systems, but also of the technical assistance that accompanied the budget support and, sometimes, of the attention given to this issue in the policy dialogue (conditionality) (IDD and Associates 2006).

In principle, it is possible that the parliament and civil society use the same reports and accounts that the government prepares for donors so they can monitor and assess government performance. In this way, budget support may contribute to transparency and accountability and, therefore, to the improvement of democracy. However, in Tanzania, where most aid is given in the form of general budget support and where there is an extensive system for reporting to donors about the execution of the total budget, neither parliament nor civil society has shown interest in these reports (Booth et al. 2004). It seems that as long as the money “is falling from the sky,” the population and its representatives are not interested in knowing how it is used. This means that, in this case, budget support did not have a positive political effect. Thus, outward accountability continues to be stronger than inward accountability. This also means that most likely nothing will change in terms of political clientelism. It can also be assumed that in the case of budget support, donors do not have much control over the use of the funds. In countries where budget support makes up a large part of total aid, the possibility that funds will be diverted or poorly used increases (Cammack 2007: 607).

With respect to economic costs, this same DAC evaluation concludes that problems exist with the volatility of budget support. A distinction is made between predictability during the year in progress (disbursement schemes) and medium term predictability. The latter depends on the level of compliance with the preconditions and the policy matrix. Reducing the former (the predictability during the year) is easier and some progress was observed. It was more difficult, however, to achieve more disbursement stability in the medium term. In some cases, donors underestimated the political risks at the beginning, and this led them to not disburse the amounts committed. Likewise, the evaluation found that different donors have different criteria for fiduciary and governance risks (IDD and Associates 2006). All of this means that commitments do not always materialize and that aid in the form of budget support can put economic stability at risk. In one study of eight African countries, Celasun and Walliser studied the deviations between budget support projections (made by the IMF) before the fiscal year and the actual disbursements made. The average absolute deviation for the 1993–2004 period is 1% of GDP, and is a little lower during 2000–2003 than in 1993–1999. Thus, it would seem that there has been progress. But there are great variations between countries and years (Celasun and Walliser 2005).

With respect to conditionality, the DAC evaluation concludes that when domestic support exists for certain policies, budget support can contribute to the implementation of these policies and to achieving their objectives. This happened in some countries in the area of public finan-

¹³ The replacement of national planner was the responsibility of both sides. Donors preferred it that way and the government accepted it, knowing that the government would be able to continue to make the important decisions.

cial management (IDD and Associates 2006). Apart from conditions related to financial management, the conditionality of budget support is generally directed at reducing poverty. This conditionality includes targets for pro-poor expenditures in addition to specific policies and targets for reducing poverty and improving social indicators. In the five countries where budget support was being implemented, the same evaluation found that social spending had increased, which could be attributed to the conditionality or to the additional available resources. According to various studies, the conditionality related to poverty – which is applied also in all HIPC countries – has been successful in the sense that pro-poor spending has increased in these countries (Mosley et al. 2004; IDA and IMF 2006).¹⁴

Few conclusions can be reached thus far with regard to the effectiveness of the money invested in budget support. Previous evaluations of program aid concluded that the money generally had a positive effect on economic growth by positively impacting imports and macroeconomic stability. While governments still had high fiscal deficits, the freely available resources¹⁵ helped to finance these deficits (White and Dijkstra 2003). Currently, budget support is given to countries that have already solved their fiscal deficit problem; however, the volatility of aid can even affect macroeconomic stability.

The DAC evaluation of budget support concludes that budget support contributed to improving efficiency in the allocation of fiscal spending by giving governments more freedom to choose, for example, between current expenditure and investment expenditure (IDD 2006). On the other hand, increased spending on social sectors did not lead to better social indicators. Sometimes access indicators improved, for example, in primary education, but there is also evidence of a decline in the quality of education (IDD and Associates 2006). The evaluation of budget support in Tanzania concluded that the abundance of funds for social sectors even reduced efficiency in the use of the funds (Booth et al. 2004). In the HIPC countries, primary coverage indicators improved, but maternal mortality and infectious disease rates deteriorated (IEG 2006).

¹⁴ But this is of course at most an intermediate outcome, not a goal in itself.

¹⁵ Though balance of payments support sometimes came tied to goods, once the imported goods were sold, the government had freely available resources.

4 Changes in Aid in Bolivia, Honduras, and Nicaragua

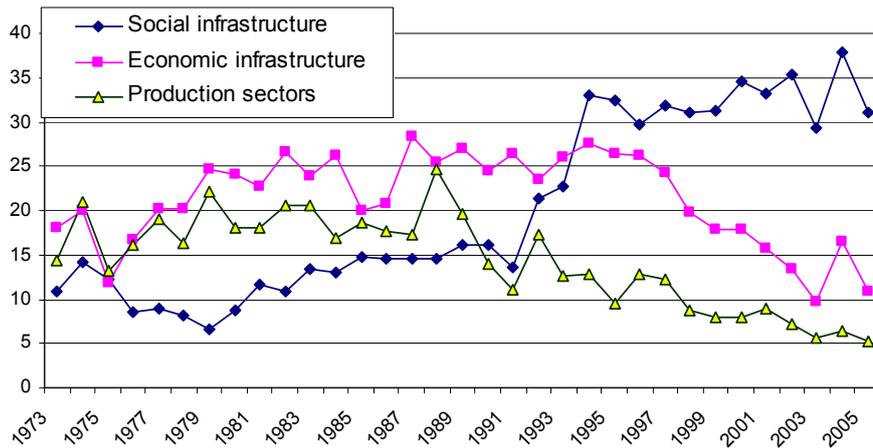
This chapter looks at whether the PRS process has changed foreign assistance in these three countries. We will look at volume, sectoral allocation, modality (whether there is more program aid now), volatility, conditionality, alignment, and harmonization.

4.1. Volume

Bolivia and Nicaragua have received a great deal of aid for quite some time. In Bolivia, many donors came into the country after macroeconomic stabilization was achieved in 1985. In Nicaragua, the international community returned in 1990 when Violeta de Chamorro won the elections. While Bolivia and Nicaragua received approximately US\$500 million annually (excluding debt relief), in Honduras, the amount was lower (Figure 4.1). But it must be taken into account that the local data for Honduras do not include grants. If we add the grants as registered in the Global Development Finance database of the IMF, the aid volume to Honduras was about US\$ 350 millions annually before 1999, and about US\$ 400 millions in the years 2000-2003.¹⁶ In Honduras, the amount of aid spiked after Hurricane Mitch hit the country in late 1998. From 2004 onwards, the grants volume to Honduras increased substantially, probably because debt relief is included in these figures. In none of the three countries is there a structural increase after 2000 with the arrival of the PRS. However, if we include debt relief, the volume of aid did increase since 2001 (Table 4.1).

¹⁶ Obviously, it is not possible to compare fully data from different sources. For example, GDF data are commitments while the local aid data are disbursements.

Figure 4.1. Foreign Aid Disbursements, 1995–2006, in Millions of US\$.



Note: The line for 'Honduras' does not include grants; that for 'Honduras*' does, based on data from IMF, GDF online. Source: Elaboration based on country studies using VIPFE data in Bolivia, SEFIN data in Honduras, and Central Bank of Nicaragua data in Nicaragua.

However, the numbers in Figure 4.1 and Table 4.1 are in nominal dollars. In order to assess the importance of aid for the country's economies, we must look at the relation with National Incomes (Figure 4.2). It is very evident now that aid plays a much more significant role in the economy of Nicaragua than in the other countries, and that it is more significant in Bolivia than in Honduras. The level of aid for the late 1990s shows a downward tendency in all three countries, following the tendency for aid in general (Figure 2.2 above). Of course, there is an exception in 1999 as a result of Hurricane Mitch, especially in Honduras but also in Nicaragua. The year 2003 was a special case in Bolivia because of the economic and political crisis; donors were forced to contribute with high amounts of money in balance of payments supports in order to avoid capital flight and an even greater external crisis (see also below). In Nicaragua, the aid trend has been very erratic.

Table 4.1. Foreign Aid in the Three Countries, Annual Averages per Period

	In US\$ millones ¹				In% of GNI ²	
	Excl. debt relief		Incl. debt relief		1995–2000	2001–2005
	1995–2000	2001–2006	1995–2000	2001–2006		
Bolivia	542	537	574	699	9	9
Honduras	268	271	269	355	9	8
Honduras*			426	616		
Nicaragua	518	549	518	770	20	21

¹ For Honduras the numbers do not include grants; those for Honduras* do.

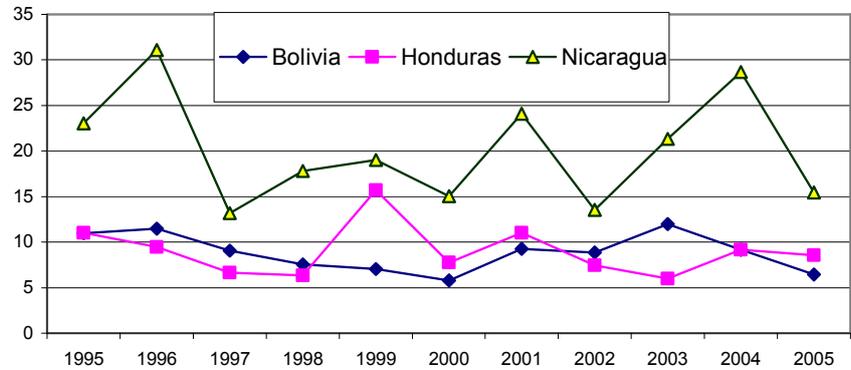
² Source for these figures: World Bank, World Development Indicators (WDI) on line. Data on aid are from OECD-DAC, those on GNI are World Bank estimates.

Source: see Figure 4.1

Since these numbers do not include debt relief, we may ask whether the tendencies would be very different if the relief were included. It could be that the HIPC relief, both from the Paris Club and the multilateral institutions, has substituted for regular aid in the last few years. In general, the amount of aid is higher in the three countries during the second period if debt relief is included (Table 4.1). The country studies of Bolivia and Nicaragua conclude that HIPC relief, both from the Paris

Club and from multilateral institutions, has generally been in addition to the usual amount of aid given. In Honduras, there is certain evidence of substitution. But in all three countries it is clear that the application of MDRI led to a reduction in the new concessional loans from the World Bank. We can say then, that relief based on the MDRI is not additional.

Figure 4.2 Foreign Aid in% of GNI, 1995–2005



Source: World Bank, WDI online 2007.

4.2. Sectoral Allocation

In terms of the sectoral allocation of foreign aid, information only exists for Bolivia and Honduras, and in Honduras, once again, only concessional loans are included. Results show that in Bolivia, the amount allocated to the social sectors was already high during the 1990s (almost 30%) and that it has decreased a little since then. In this country there was already a lot of attention for improving social indicators in the 1990s (more than in the other two countries), both within government and among the donors. The allocation to production sectors has decreased in the second period, despite the fact that the new national plans from 2003 onwards gave a lot of attention to stimulating production. In Honduras, attention to social sectors appears to have increased with the PRS, going from 15% total to 22%. In Honduras, the multi-sectoral allocation is very high, which also means relatively low amounts for infrastructure and production, though this last category has grown in the second period.

Figure 4.3. Bolivia: Aid Allocation by Sector, in%

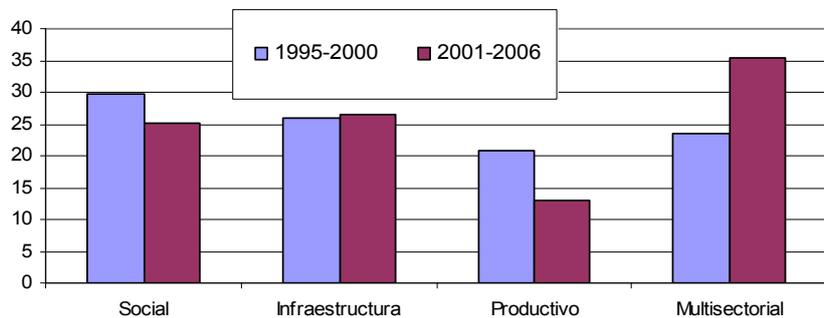
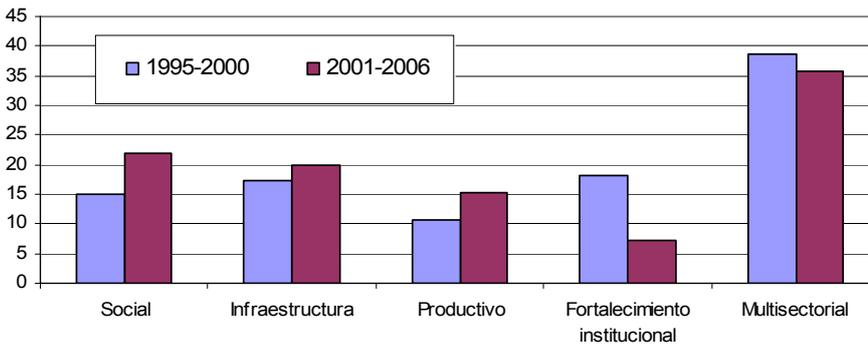


Figure 4.4. Honduras: Sectoral Allocation of Concessional Loans, in%



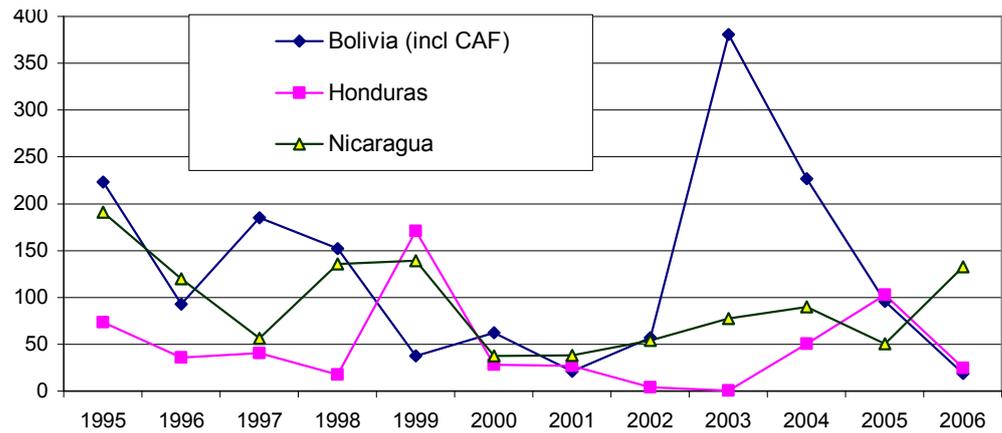
4.3. Modality

We are interested in knowing whether the amount of program aid has grown in relationship to total aid since 2001. The three countries have slightly different systems for establishing this amount. In Nicaragua, the Central Bank records the category of “freely available liquid currency” that includes all balance of payments support and budget support. It may include sectoral budget support, but definitely not the common funds or “baskets” of funds within sectoral or subsectoral programs. In Honduras, we have used three categories of “monetary support” as distinguished by the Finance Secretariat (SEFIN). These were “balance of payments,” “fiscal-structural adjustment,” and “fiscal-reorganizations.” In Bolivia, “aid by sector” has been subtracted from total aid to get a category of aid not tied to specific sectors. The problem in Bolivia is that the numbers for aid by sector include non-concessional credits from the CAF, so the program aid numbers for Bolivia presented here also include CAF figures.

In Honduras, almost all program aid has come from the multilateral banks, implying that it has come in the form of concessional loans. In absolute terms, the amounts are lower than in the other countries, but relative to total aid (which also includes concessional loans only) they are similar (Figure 4.5.) After Hurricane Mitch, a high was observed. Since 2004, the European Commission has been providing sectoral budget support for decentralization, but since this is a grant, it is not recorded in the numbers presented here. Some bilateral donors are considering giving aid through the co-financing or parallel financing of the World Bank’s PRSC 2 (Sweden, Germany, and recently Spain as well), but as long as Honduras does not have a new PRGF, it cannot conclude a PRSC 2.

In Bolivia and Nicaragua, program support from some bilateral donors has always existed along side the program support of multilateral banks. Program aid has decreased slightly in both countries between 1995 and 2000, and in Nicaragua there is a slight increase after 2001. The Joint Agreement for general budget support established in 2005 along with the new sectoral budget support programs of the European Commission (EC) caused the increase in 2006. In Bolivia, the political and economic crisis produced a very large increase in aid in 2003 and 2004. In 2004, the Multi-annual Budget Support Program (PMAP) was negotiated but there were almost no disbursements in 2005 and 2006, and the Morales government is not interested so far in continuing them.

Figure 4.5. Program Aid 1995–2006, in Millions of US\$

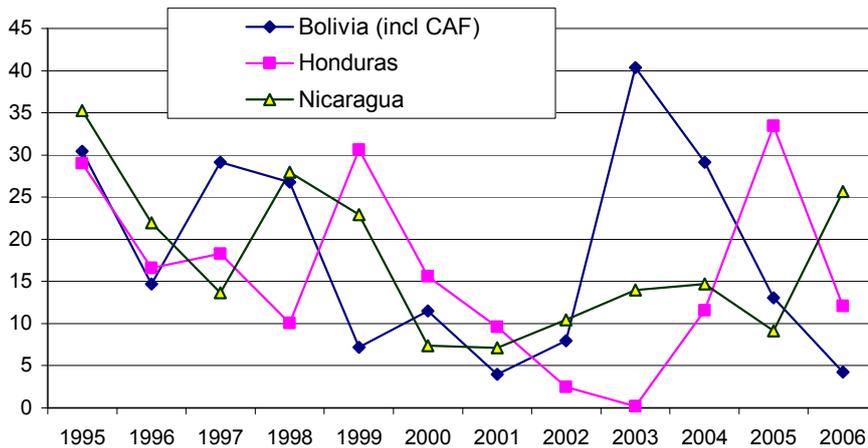


A certain relationship can be seen between the amount of program aid and the existence of an IMF program,¹⁷ especially in Nicaragua, but also in Bolivia in 2003 when the country concluded its Standby Agreement with the IMF and other donors contributed to financing the balance of payments deficit. The IMF concluded agreements with Nicaragua (ESAF or PRGF) in 1994, 1998, and 2002. The 1994 agreement went off track rapidly and only one-sixth of the aid was disbursed, which explains the reduction in program aid during 1995–1997. The 1998 agreement was maintained for a little longer, and in the 2002 agreement, the IMF disbursed the total amount. In keeping with these developments, the level of program aid went down after 1998–1999, and increased somewhat after 2002. But the volumes between 1999 and 2002 are also due to the effect of hurricane Mitch in 1999, and increasing evidence of corruption of the Alemán administration during 2000–2002. Honduras concluded one ESAF in 1992 and other IMF programs (PRGF) in 1999 and in 2004. The latter two contributed to temporary spikes (1999 and 2005 respectively) in program support.

In general, it cannot be concluded that the percentage of aid given in the form of program aid has grown after 2001 and that now more budget support is provided instead of project aid. In Bolivia and Honduras, the movement is erratic. This is even more visible in Figure 4.6 showing program aid as a percentage of total aid. As mentioned above, the sharp increase in program aid in Bolivia in 2003 and 2004 is due to the crisis and was given in the form of balance of payments support, not as budget support. In Nicaragua only, there does seem to be a tendency for budget support to increase, at least through 2006. But there, the volatility of budget support has not been resolved, since there was a decrease in 2005.

¹⁷ Disbursements from the IMF program itself are not included in these numbers, and in any case they are relatively small.

Figure 4.6. Program Aid as% of Total Aid



4.4. Volatility

Volatility can first be analyzed according to the tendencies shown in the graphs (Figure 4.1 for total aid and Figure 4.5 for program aid). The greatest volatility occurs in Honduras, but this is due primarily to the emergency aid provided after Hurricane Mitch in 1999; and within total aid, the 2005 high is probably due to debt relief. Bolivia, during its year of crisis, experienced a sudden increase in aid and then a sharp decline in 2006. In Nicaragua, aid has been quite stable. There doesn't appear to be a change in volatility after 2000, that is, after the beginning of the PRS process. These conclusions are confirmed by calculating volatility by country and by period: Honduras has the highest level and Nicaragua the lowest. Table 4.2 also shows that the volatility of budget support is much higher than the volatility of aid in general. Once again, Nicaragua is the most stable country.

Table 4.2. Volatility of Total Foreign Aid¹ and Program Aid during Different Periods²

	All Aid			Program aid		
	1995–2006	1995–2000	2001–2006	1995–2006	1995–2000	2001–2006
Bolivia	0.16	0.12	0.20	0.80	0.53	0.98
Honduras	0.42	0.50	0.32	0.96	0.85	0.99
Nicaragua	0.09	0.12	0.06	0.51	0.46	0.43

¹Calculated as standard deviation/average, by period.

²Donations are not included for Honduras.

Sources: See Figure 1.

4.5. Conditionality

In this section we look at whether the quantity and type of conditions accompanying the program aid modality has changed with the PRS. In each country, we compare: 1) a World Bank adjustment loan from before 2000 with a PRSC or similar program after 2000; 2) an IDB loan based on sectoral policies before and after 2000; and 3) the bilateral balance of payments support before 2000 and bilateral budget support after 2000.

One interesting dimension to start with is selectivity versus conditionality. If donors are stricter in selecting the countries to which they give program aid, they need fewer conditions and can leave more autonomy to the government, giving them more ownership.

In this sense, the criteria, fundamental principles, or preconditions are important for this aid modality. One criterion that is always part of

the agreement is that of maintaining macroeconomic stability. Generally, donors leave the verification of this criterion to the IMF. In practice, having an agreement with the IMF, or being “on track” with this agreement, is almost always a precondition for budget support.¹⁸ This was a very strict criterion for multilateral banks before 2000 and appears to continue to be a strict criterion for the World Bank after 2000. The IDB now sometimes provides budget support when the country does not have an agreement with the IMF; to Bolivia in 2006, for example. In Nicaragua, the Budget Support Group decided in 2006 to remove the criterion of having an IMF agreement from its Joint Agreement and to maintain some of its own indicators for measuring macro-economic stability. But in practice, the indicators are very similar to those used by the IMF. It is probably too soon to conclude that the importance of staying on track with the IMF has lessened in the last few years. Even before 2000 there were examples of bilateral donors that did not want to follow the Fund’s opinion strictly (White 1999). And on the other hand, it still appears to be very difficult to convince the headquarters of the bilateral donors to give budget support in cases where there is no IMF agreement.¹⁹

Apart from macro-economic stability, bilateral donors have always required countries to comply with other conditions or “fundamental principles” before providing program aid, especially in the political realm, including for example, the respect for human rights, democratic freedoms, judicial independence, and a political commitment to combating corruption. After 2000, two more preconditions have usually been added to the budget support modality: a commitment to reduce poverty, expressed usually in the form of a PRS, and basic guarantees for good management of public finances. In practice, the countries hardly ever meet all of these conditions. We have already observed previously (Vos et al. 2005) that there is little relationship in these three countries between the existence of a PRS and the existence of the budget support modality. Donors established a Multi-annual Budget Support Program (PMAP) in Bolivia when there was no approved PRS, while Honduras—though it always had an up-to-date PRS—received hardly any budget support from bilateral donors. In Bolivia and Nicaragua, joint agreements for budget support were concluded although not all of the preconditions were met. There were doubts about public finances in Bolivia, and in Nicaragua it was clear that there was neither judicial independence nor a commitment to combat poverty, even though both were mentioned among the “fundamental principles” of the Joint Agreement for budget support that the country was supposed to live up to in order to continue to receive budget support. Currently, very little budget support is being given to Bolivia. This is not because the country has not complied with the preconditions, however, but rather because the government is not showing much interest in receiving this aid modality.

If the preconditions for budget support are not met, it means that there isn’t much congruence between the objectives and priorities of the donors and the objectives and priorities of the receiving government. In these circumstances, one can expect that there will continue to be a great deal of conditionality imposed by donors rather than a situation in which aid is based on the priorities of the receiving country. Donors try to achieve their own objectives, including the preconditions, through the policy dialogue with the government and through the Performance

¹⁸ In practice, an agreement with the IMF does not mean that macroeconomic stability exists, as evidenced by the situation in Bolivia in 2003. Apparently, donors are hoping that the IMF agreement will help the country reach that stability.

¹⁹ Based on interviews conducted with donor representatives throughout the five years of this study.

Assessment Matrices that are the result of this dialogue. The analysis of conditionality confirms this conclusion.

The number of conditions for general loans (structural adjustment or PRSC) has not gone down in Bolivia, nor has it declined between the IDB sectoral budget support loans for “fiscal adjustment” (1998) and “fiscal sustainability” (2003) (Table 4.3). In Honduras, we were not able to find a structural adjustment loan document from before 2000, but the number of conditions in the PRSC (2004) is very high and the same is true of the PRSC in Nicaragua (Dijkstra 2005). In Bolivia, the number of conditions on budget support from bilateral donors has increased, though the number of conditions on the PMAP is still modest (23) in comparison to the Joint Agreement in Nicaragua (160 in 2005, 115 in 2006) (Komives and Dijkstra 2006).

Both before and after 2000, the number of conditions associated with results is very low (Table 4.3). Most conditions continue to refer to processes: measures, policies, institutional changes, etc., so donors are still not leaving much space for ownership by the governments – which was to be expected since donors don’t have much confidence in the governments’ policies.

In policy matrices, all of the conditions are generally seen as equally important and are expected to be met before the first or the second disbursement. In practice, we know that donors frequently continue disbursing money even when conditions are not complied with. In some newer World Bank loans, however, some conditions are defined “triggers” for disbursements. This indicates that other conditions are not always expected to be met. At the same time, it could mean that the World Bank is stricter with these triggers. Along the same lines, the IDB introduced a new type of policy-based loans called “performance-based loans,”²⁰ in which a large part of the money is only disbursed after some targets are met. A few years ago, the European Commission began with budget support grants in which part of the disbursements – the “variable tranche” – also depends on the level of compliance with conditions or targets established in the contract. All in all, the amount of preconditions, triggers, or targets that must be achieved before disbursements occur, seems to have increased after 2000.

Table 4.3. Conditions on Program Support Before and After 2000

Bolivia	Total	Process	Result
Structural adjustment credit, 1991	67	66	1
SSPSAC 2004	42	40	2
SSPC 2 2005	46	39	7
IDB: Fiscal adjustment and maintenance of social spending program, 1998	24	22	2
IDB: Fiscal sustainability program, 2003	40	38	1
Bilateral: MDF 1997	5	4	1
Bilateral and multilateral: PMAP 2005	23	20	3
Honduras	Total	Process	Result
WB: Program to modernize public sector, 1996 (Public Sector Structural Adjustment Credit)	27	26	1

²⁰ In the health sector in Honduras, for example.

IDB: Public sector reform program, 1995	27	26	1
IDB: Strengthening fiscal management, 2004	5	5	0
PRSC 1 2004	73	72	1
IDB: Sectoral program associated with PRS, 2006	56	56	0

Source: Bolivia and Honduras Country Reports, 2007.

What has actually changed is the content of the conditions. Prior to 2000 the emphasis was on fiscal and monetary policies, in addition to structural reforms like privatization and liberalization, but lately there is more attention to policies for social sectors. A condition on the volume of pro-poor spending, or PRS spending, within fiscal expenditures is almost always included. Conditions related to fiscal reforms, social security and pension reform, privatization of water, energy etc., and reforms to laws and regulations related to the private sector and environmental policies continue to be important, however. Officially, the conditions are based on the PRS, but in practice, the PRS is either not sufficiently concrete or it is not in force or up to date. Many of the conditions, therefore, come out of negotiations between donor(s) and government in a way that is very similar to the practices that existed before the PRS processes.

In Nicaragua, no change can be seen in conditionality after the PRS process: donors continue to require structural reforms of the structural adjustment type (Country report 2007). There is also a high coincidence between the requirements of the IMF and those of other international financial institutions like the World Bank and the IDB, which often act as operational arms of the IMF. It seems that lately, with the arrival of President Ortega, the pressure of conditionality has decreased, in spite of the fact that some of the earlier required structural reforms have not yet been implemented.

4.6. Alignment and Harmonization

Officially, PRSs are the basis for decision-making on all foreign assistance. In practice, however, there hasn't been much progress in alignment or in harmonization. The original PRSs did not define very strict priorities and, in practice, they left room for all foreign aid activities. National plans established after the first PRSs were often farther reaching, since they were development plans, but they didn't have very clearly defined and operationalized priorities either. Nevertheless, it does seem that the EC used the PND to establish its conditionality in Bolivia (2007 Bolivia Country Report). In practice, alignment with the priorities of the government came to depend much more on the capacity and commitment of the government itself to defining sectoral priorities and for providing leadership of donor coordination in sectoral round tables or similar spaces. In Bolivia, some roundtables functioned well between 2003 and 2005, depending on government leadership in the sector. The establishment of the PMAP, for example, was an achievement of the fiscal roundtable. In Honduras there was a sudden increase in attention to this issue in 2003, when the government organized a workshop on the coordination of foreign assistance. But in later years, little progress was made in drawing up sector-wide plans. The only concrete result was the EFA (Education for All) that included a common fund from some of the participating donors. 2005 was another election year in which the donor coordination process stagnated. In Nicaragua, there were also sectoral round tables, some of which functioned well during the years of the Bolaños administration (2002–2007). Sectoral policies were drawn up for

education and health and donors began to support them. But the execution of these policies on the part of the government appears to have been deficient (Komives and Dijkstra 2006).

The three countries have written Alignment and Harmonization Plans in the context of the Paris High Level Conference on this topic, in 2005 – Bolivia before the conference, and Honduras and Nicaragua afterwards. These plans revealed the level of progress made thus far in harmonization and alignment with government systems: budget, execution, auditing, and monitoring, etc., making it clear that there is still much left to do. The Nicaraguan plan is the most elaborate one, mentioning concrete measures and defining targets to be achieved. However, all three plans were written under past governments, so it is not clear that there will be any follow-up on all of these good intentions (Komives and Dijkstra 2006). In Nicaragua, for example, the process has stagnated after the change in government in 2007.

The Bolivia and Honduras country reports also observe a deficiency on the part of donors in their support for poverty reduction strategies, and in supporting monitoring systems in particular. Specific support has been given at different times for certain data collection systems, but there is still no structural, coordinated and long-term support for institutions responsible for gathering and publishing statistics (INE) and for creating and monitoring the plans (UDAPE in Bolivia, for example).

4.7. Conclusions

As Table 4.4 shows, the PRS process has not changed the aid to the three countries very much. The volume of aid has not grown and volatility has not decreased. The volatility of program modalities is much higher than that of total aid. Program aid is usually still conditioned on having an agreement with the IMF and on being “on track” with that program. It also depends on other political and institutional conditions. In the case of Bolivia, program aid has decreased because of a lack of interest on the part of the Morales government. In Nicaragua only, this type of aid has increased slightly between 2001 and 2006.

Not much has changed in terms of selectivity. Honduras, the only country with a PRS in effect during the entire period, received less budget support from bilateral donors than the other countries did. This was not because the country complied in any lesser degree with some other preconditions, but rather because of the composition of the group of donors in that country. In Bolivia and Nicaragua, there were also problems with the preconditions but this did not stop bilateral donors in those countries from establishing budget support agreements. It is not a surprise, then, that neither the weight of the conditionality nor the volatility changed much.

Table 4.4. Changes in Aid around the Year 2000

Dimension	Results Internationally	Bolivia	Honduras	Nicaragua
Volume	Has grown but mostly because of debt relief	Has not grown	Has not grown	Has not grown
Sectoral Allocation	More attention to social sectors, but this has been true since the 1990s before the PRS	Attention to social sectors went down, but from an already high level	More attention to social sectors	
Modality: Budget Support	Official data lacking, but according to SPA data, appears to be high in Africa	Lower, very volatile and decreasing since 2003	No change, mainly from multilaterals, very volatile	Slight growth since 2001
Volatility	Has not decreased	Has not decreased; higher for budget support	Has not decreased; higher for budget support	Has not decreased; higher for budget support
Selectivity	Has not increased, at least not up to 2003	A lot of budget support with IMF agreement in 2003; little selectivity in other criteria (PRS or quality of public finances)	Related to agreement with IMF	Related to agreement with IMF; Little exigency regarding commitment to reduce poverty or other "fundamental principles."
Conditionality and Ownership	Tension between PRS as a condition and presumed national ownership of the strategy; Traditional conditionality was not reduced and did not change in nature: Many structural conditions Many conditions about processes and not just results Many preconditions	Few changes in conditionality: Number of conditions high; Traditional conditionality is maintained on structural reforms while PRS conditionality like pro-poor expenditures and policies for social sectors are added; Few results-related conditions; More preconditions than before	Few changes in conditionality: Number of conditions high; Traditional conditionality on structural reforms is maintained and pro-poor spending and social-sector policy conditions are added; Few results-related conditions; More preconditions than before	Few changes in conditionality: Number of conditions high; Traditional conditionality on structural reforms is maintained and pro-poor spending and social-sector policy conditions are added; Few results-related conditions; More preconditions than before
Alignment and Harmonization	Very slow progress	Very slow progress	Very slow progress	Some progress until 2007

5. Effects of Programmatic Modalities on Aid Efficiency and Effectiveness

In this section we summarize the experiences of the three countries in terms of the effects of programmatic aid modalities on the efficiency and effectiveness of aid. We have already concluded that there has not been much of a real increase in the amount of budget support. The statistics presented earlier, however, do not include the sector-wide approaches (SWAs). All three countries have some experience with SWAs, albeit in the form of subsectoral programs like EFA (Education for All) in Honduras, the Primary Education “Basket” in Bolivia, and FONSALUD, PRORURAL and a common fund in education in Nicaragua.

We cannot arrive at quantitative conclusions about the transaction costs involved in (sectoral) budget support or SWAs as compared to those of projects, but we can present some observations and perceptions about the experiences in the three countries. We also look at whether these aid modalities brought about other expected intermediate effects with these aid modalities, particularly the use and strengthening of national systems, and a greater degree of compliance with the conditions. For effectiveness, we have to rely on an assessment of these intermediate effects – definitive conclusions on effectiveness are not yet possible. Along with general budget support, we discuss the experiences of the sectoral programs dealt with in the 2007 country reports, in particular the education basket and PASAAS (an EC water and sanitation program) in Bolivia, the EFA in Honduras, and PRORURAL in Nicaragua.

5.1. Transaction Costs

In general, it is clear that sectoral approaches and budget support are still just a small percentage of all foreign aid agreements in the three countries. This is due not only to a lack of will on the part of the donors, but also because, in many cases, government officials have also lacked the will to propose more (sectoral) budget support or because there has been a lack of capacity to execute and manage substantial amounts of foreign assistance in a sectoral program. Because of the large number of projects that still exist, it is unlikely that transaction costs have decreased significantly in relation to total aid. Furthermore, reports from previous years already observed that various donors still maintain parallel systems of budget support and that there is little coordination between these systems. This also increases transaction costs.

Various costs must be taken into account when calculating the transaction costs for general budget support. Given that a PRS is a condition

for it, the time and resources spent preparing the PRS would have to be included, for example. These have been very significant (see our 2003 country reports), especially considering the fact that the strategies have hardly been used in practice. In addition, we must include the costs of coordinating among donors for joint agreements (Bolivia and Nicaragua) or for trying to achieve co-financing or parallel financing of World Bank loans (Bolivia and Honduras), and the costs of negotiating with the government in all cases. The budget support groups generally do not replace other donor groups. Rather, they are additional groups that require the attention of high level government officials.

Three donors are participating in the Education Basket in Bolivia. At the beginning, they simply funded the Multi-Annual Operational Plan (POMA) for the education sector. Once the agreement was established, the transaction costs were limited to monitoring the POMA's execution. However, the current government is no longer implementing the POMA. Now, donors are approving specific activities to be funded from the Basket [or "package of educational goods and services"]. This set-back implies greater transaction costs.

In the case of the EFA (Honduras), there is a sub-sectoral plan supported by eleven donors. But only six of them participate in the common fund and three more participate in the Education Donors Roundtable. All of this creates many additional frameworks for coordination and negotiation. Furthermore, both the government and the donors treat the common fund as a project: the government asks donors for approval, and donor representatives – who frequently happen to be specialists on the sector – engage intensely in the discussions on policies to be followed. As a result, transaction costs are still quite high.

PRORURAL is a sector-wide program in which both the government and all involved donors signed a Code of Conduct. Four bilateral donors support the common fund, for which they negotiated and signed a Memorandum of Understanding. Other donors support the program only through projects (WB, IDB, ED, Austria, AID, Japan). The US Millennium Challenge Account stayed out of this program in spite of the fact that it works very intensively in the rural sector in two Nicaraguan provinces. There were (and still are) high costs for coordination among donors, and between donors and government officials. On the other hand, some transaction costs have decreased. For example, missions are almost always joint missions and all donors involved, including the World Bank, accept a single report from the government on progress made in the program.

5.2. Use and Strengthening of National Systems

The PMAP in Bolivia contributed to reinforcing the national system of financial management, especially because the contents of the policy matrix supported the government's medium term action plan for improving the government's fiscal management and transparency. The IDB's fiscal sustainability program also supported this strengthening through its conditions, but its implementation was somewhat contradictory in that it was managed from a separate implementation unit and used a special account. In reality, it was more a project than budget support. The SSPSAC and the SSPC of the World Bank contributed somewhat to strengthening the statistical information systems. But a general weakness of all of these programs was that they never identified the need to create a base line for verifying progress in the various areas.

The donors of the Education Basket in Bolivia used national systems for managing expenditures, knowing that those systems were very deficient. They tried, and to a certain extent succeeded, in improving the systems. But they recognized that there are limits to what can be achieved at this sectoral level, since financial and accounting systems need to be improved at the national level. The PASAAS Program of the EC in Bolivia supports the water and sanitation sector through what is supposed to be sectoral budget support. In the first years of this agreement, part of the funding was for some specific projects under a special executing unit, so this program continued to have some of the disadvantages associated with project aid.

In Honduras, the PRSC 1 helped to reinforce the public management systems SIAFI (financial system) and SIERP (PRS Information system) and required the government to use SIAFI beginning in 2005. The IDB also supported SIERP, but the aid was not sufficient. Systematic support to INE was needed to provide SIERP with statistical information, but unfortunately this was lacking. The donors of the EFA common fund use government systems for its management, but in practice donors are heavily involved and the common fund is managed practically like a project. In addition, the EFA program itself is not the result of a government plan. The objectives, teaching measures, proposals for institutional reforms, and textbooks were actually all created and designed by donors like USAID, World Bank, and JICA. Therefore, the common fund donors don't seem to align themselves with the priorities and planning of the government. To a certain extent, they are aligning with the priorities and projects of other donors.

In Nicaragua, public financial management systems have improved during the Bolaños administration, but it is not clear to what extent the provision of budget support contributed to this. Improvement in public financial management systems was a priority of the government itself, and was supported by a technical assistance program of the World Bank and several other donors, the PSTAC (Public Sector Technical Assistance Credit). The PRORURAL common fund uses government systems for planning, procurement, monitoring, and evaluation. But the World Bank believes that the systems are not sufficiently developed and so it keeps its projects separate from these systems. PRORURAL includes a technical assistance fund for strengthening government capacities, but the results of this fund are not yet known.

5.3. Implementation of Conditions

Given that selectivity was rarely applied and that conditionality has not changed much in comparison to the 1990s, it is to be expected that countries do not always comply with conditions. While conditions are generally negotiated between donors and the receiving country, non-compliance was very common during the 1990s, whether due to lack of commitment on the part of the government, a lack of political viability, or a lack of technical capacity for execution.

In Bolivia, there have been many instances in which the country did not meet the conditions of budget support. The response of the donors has varied: in some cases, they reduced the amounts of their disbursements, as the IDB did in the fiscal sustainability program when the government did not implement reforms in the national social security system. In other cases, donors adjusted and softened their conditions. The World Bank combined the two responses: it removed the conditions on the water and sanitation system in its SSPC 2, but at the same time, it

reduced the amount of its commitment from \$25 million to \$15 million. The EC (PASAAS) disbursed less money than it had planned on its variable tranche in 2006 due to lack of compliance with some targets in 2006. But this money is not lost and can be disbursed at the end of the program. Furthermore, the EC negotiates each year on new targets and has proven to be quite flexible in adjusting them. The conditions for the Education Basket were related to policies, not to results. Donors only monitor some administrative procedures, the use of resources, and progress in execution. Even so, the donors observed non-compliance in some cases but were flexible in continuing their disbursements.

In Honduras, the most visible case of non-compliance is the Civil Service Law that the Congress had to pass so that the second phase (second year) of the 2004 PRSC could be approved. The government was able to draft the law (condition for the first phase), but Congress did not pass it. The World Bank then did not disburse the second phase and instead negotiated a new PRSC 2, which only introduces some pilot projects for establishing merit-based administrative careers, based on an already existing law. The disbursements of the EFA program stagnated after the 2006 change in government because the new administration did not at first recognize this program as one of its priorities.

In the case of Nicaragua, we have already written extensively about non-compliance with the IMF in 2005 and about the response of donors in the Joint Agreement for budget support (Komives and Dijkstra 2006, Guimaraes and Avendaño 2006). In this case, the donors in fact increased the leverage of the IMF to ask for and approve more reforms.²¹ In 2007, budget support continued despite the fact that there was no IMF agreement until October. In general, Nicaragua has a tradition of approving reforms when there is a great deal of pressure from donors, but afterwards it tends to accept, accommodate, or approve setbacks, exceptions, or other ways of not completely implementing the things that it committed to do.

5.4. Conclusions

The following statements summarize the intermediate effects of the flexible modalities:

- In spite of some positive effects in donor coordination and alignment with government priorities, transaction costs are still high.
- Experiences with using national systems are varied; some programs do not use national systems even though they are called (sectoral) budget support programs.
- There are some examples of programs that were able to strengthen national systems, especially in financial management.
- In order to achieve a strengthening of domestic systems, there is a need for a more comprehensive approach on the part of donors in the area of strengthening information systems, as well as a high level of ownership (political commitment) on the part of the receiving government.
- In several cases the countries did not actually implement the conditions that were mutually agreed upon. Sometimes this was due to a lack of commitment or political will on the part of the executive itself; sometimes it was a lack of political viability; and in other cases it was a lack of capacity for implementation.

²¹ This effect was probably not intended but was the result of holding up budget support until the IMF, by writing a comfort letter, reassured that macroeconomic stability was not in danger.

It is difficult to arrive at a conclusion about the effectiveness of these modalities for supporting poverty reduction. On one hand, it is still too soon to do it. On the other hand, many factors independent of foreign aid influence the results. In the case of budget support, the funds are mixed with fiscal income and so their specific use cannot be monitored, let alone that conclusions be reached about their particular effects. It is only possible to assess their impact through intermediate results. The analysis makes clear that in many cases, this modality has not resolved the problems of project support. With some exceptions, a lack of ownership persists, and there is little alignment and harmonization.

6. Commitment, Capacity, and Results

In the previous chapters of this report, we have looked at how foreign aid has changed during the last seven years in Nicaragua, Bolivia, and Honduras, and to what extent aid has become more effective in reducing poverty. In this chapter, we look at the performance of national governments and attempt to respond to the following questions:

- Has government capacity for implementing pro-poor policies and programs improved?
- Are we now seeing a greater commitment to poverty reduction on the part of national governments?
- What have been the results of the PRS process in terms of poverty reduction?

First we describe the changes observed in political discourse and national plans. Then examine whether there is any evidence that this discourse has been translated into actions or if government capacity for translating ideas into actions has improved. For this analysis, we seek to answer the following questions: Are the proposed policies being implemented? Has there been an effort to redistribute spending or the tax burden? Does the government have more of its own resources to invest and spend? How are national resources being spent? We close the chapter with the current state of monetary poverty and the Millennium Development Goals in the three countries.

6.1. Discourse, Policies, and Execution Capacity

6.1.1. Political Discourse and National Strategies

In all three countries, poverty now has a more central place in political discourse and national plans than it did before the PRS process. The factors that have driven this change and the nature of discussions around poverty are different in each country, however.

In Honduras, the PRS process gave a significant boost to the discussion among the technical officials of the government on how to reduce poverty, though it was not able to “expand the traditional concept of combating poverty” (Cuesta et al. 2003). It wasn’t until the advent of the HIPC II debt relief initiative that this discourse about the PRS, and poverty reduction in general, was elevated to the political level. President Zelaya mentioned the PRS in his first presidential address, and the National Congress also began a debate about how to distribute HIPC

resources. So, the PRS has been consolidated as a reference point in political discourse about the problem of poverty (De Jong et al. 2007). Currently, the Zelaya government (at the request of the IDB) is modifying its PRS and is continuing the technical discussion about what the best strategy is for fighting poverty in Honduras. The aim is to improve the effectiveness of social spending by offering packages of services to the poorest communities and by generating a more “pro-poor” growth pattern through job creation and support for micro-enterprises.

In Nicaragua, the changes that have been seen recently in the discourse on poverty are due in large part to the fact that a leftist government has come to power, and not so much to the PRS as such. Before beginning the PRS process, the Nicaraguan government reached an Enhanced Structural Adjustment Facility (ESAF) agreement with the IMF on a social development plan for the country that included strengthening human capital and creating a social safety net. The PRS process assured that poverty reduction (and especially social protection) would continue to be a topic of dialogue with donors during the Bolaños administration, but poverty never actually occupied a central place in this government’s political priorities. President Bolaños’ priorities were more related to economic growth and strengthening the State. President Ortega, on the other hand, affirmed in his first presidential address that poverty reduction would be a primary objective of the government. In order to meet this objective, he plans to make changes in social policies (e.g. free education) and to respect, but modify, neoliberal economic policy. The government also introduced a literacy program and the “Hambre Cero” (Zero Hunger) program, which will distribute productive grants to 15000 families each year. A revised version of the National Development Plan is being prepared to reflect this modified vision and the new programs.

In Bolivia, political discourse about the problem of poverty goes back to before the beginning of the PRS process. In 1996, the first administration of President Sánchez de Lozada adopted the Strategy to Transform Rural Production (ETPA), a development strategy with an emphasis on generating more income for peasant agricultural producers. In 1998, President Banzer included the fight against poverty in his Operational Program for government. The first formal PRS (EBRP approved in 2001) had a strong emphasis on social spending and on meeting unsatisfied basic needs. Between 2000 and 2004, the national dialogues that were part of the PRS process and the PRS progress reports, as well as recurring social conflicts, helped to highlight the importance of continuing a national discussion on how to reduce poverty and “create” wealth. The importance of income generation and the development of production were increasingly emphasized. The electoral victory of President Morales elevated the level of political discourse on poverty: he talked about “eradicating” and not just reducing poverty. The government’s current economic plan is supported by the nationalization of hydrocarbons and by investing the resources generated by this sector in developing production, through the creation of a “Productive Development Bank” (Banco de Desarrollo Productivo) and the “Communities in Action” Program, among other initiatives. The empowerment of social sectors, the central role of the poor, and the creation of a communitarian state are other important goals for this government.

6.1.2 Poverty Reduction Policies

In 2006 report, we noted a great deal of continuity in policies in all three countries, even when governments changed and new governments rolled out their own plans: “Changes in discourse don’t necessarily translate into real policy changes” (Komives et al. 2007). The first poverty reduction strategies incorporated efforts that were already underway (many of which had begun in the 1990s). These policies and programs were organized into strategies, in some cases with proposals for improving or expanding the programs. In Bolivia, for example, the educational reform for primary education (begun in 1992), the health sector reform (of 1995), and the decentralization and popular participation initiatives (from 1994) were all continued. In Nicaragua, the FISE, created in 1990, was retained as were the education and health reforms of the 1990s. In Honduras, 45% of the original PRS budget went to projects begun in previous years and not to new initiatives. The FHIS (social infrastructure), the PRAF (family allocations to pregnant mothers and breast feeding children), transfers to children (IHNFA) and women (INAM), and PRONADERS were all programs in place before the beginning of the PRS process. In this sense, the PRSPs helped give continuity to national social policy. Since Bolivia was experiencing political instability and Honduras and Nicaragua took several years to reach their HIPC completion points, incoming governments were not able to translate their platforms into replacements for the original PRSs as they might have desired, nor were they able to make great changes in implemented policies.

Today, with debt relief assured in the three countries and with new governments in office, we begin to see some changes in the policies implemented. While there is still much continuity in social policies, new policies signal an intention to move in new directions, especially in Bolivia and Nicaragua, where many of the new ideas are strongly inspired by the experiences in Cuba and supported with resources offered by Venezuela.

- In Bolivia, the government of President Morales has introduced the Juancito Pinto annual grant (approximately US\$250 in cash) for 5th grade children in public schools and is rethinking educational reform. A program to transfer direct monetary resources to municipalities has begun to be implemented (paid for with Venezuelan resources), as well as a literacy program (inspired by the Cuban model), and (more recently) a Productive Development Bank.
- In Nicaragua, President Ortega has initiated programs including: free primary and secondary education (abandoning the “autonomous school” scheme which began as a structural reform in the early 1990s); a literacy program based on the Cuban model (Yo Si Puedo); free medicine for the population (with Venezuelan aid resources); credits for small producers and women workers offered through the Venezuelan National Bank of Social and Economic Development and the Ministry for Development, Industry, and Commerce, and the Zero Hunger Project (that includes capital transfers to peasant producers as well as nutrition and feeding programs).
- In Honduras, the Solidarity Safety Net Program (Red Solidaria) has begun to be implemented. This initiative regroups existing programs into coordinated aid packages for priority municipalities.

Below we analyze to what extent governments have the capacity, the resources, and the commitment to turn these new ideas into reality.

6.1.3. Redistribution and Tax Policy

One topic that has received very little attention in the last few years is the possibility of reducing poverty through income redistribution policies. Some transfer programs to individuals and families exist, and several new programs have been initiated (Zero Hunger in Nicaragua, Juancito Pinto grant in Bolivia) but the emphasis of poverty reduction strategies has been more on developing human capacities or on productive development. The primary objective of tax reforms and new tax codes has been to increase government revenue, with less attention given to income redistribution.

In Nicaragua, the 2003 Fiscal Equity Law did, in fact, make the tax system more progressive by increasing the percentage of direct taxes in the total tax income of the central government from 20.8% in 2002 to 29.5% in 2006. President Bolaños administration also reduced the tax on basic consumer goods, potable water service, household energy consumption up to 300 kWh monthly, and cement for low-income housing. The new administration has announced another tax reform that will seek greater equity in the distribution of the tax burden.

In Honduras, two significant reforms were made to the tax system during the PRS period – the Social Protection and Financial Equilibrium Law (May 2002) and the Tax Equity Law (April 2003) – with the objective of achieving government revenue above 18% of GDP. These reforms followed the pattern of other similar changes being made in most Latin American countries, including Bolivia – that is, a lower percentage of revenue generated from foreign trade, the widespread use and strengthening of the IVA (value added tax), and less significant changes in income tax (ECLAC 2006). After these reforms had been implemented, the IDB published a study about the tax system in Honduras, in which it categorized the tax system as regressive due to the tax on consumer goods and services, particularly on fuel (petroleum and its derivatives). The study found that lower-income households paid a higher percentage of income in tax than households with the highest income (Gómez-Sabaini, 2003).

In Bolivia, reforms have been aimed at increasing tax revenue by giving greater enforcement capacity to the National Tax Service (SIN). Attempts to introduce an income tax have not produced results so far. The current government had included in its platform the idea of equity in tax collection, but so far, it has not set about revising the tax system. It has, however, introduced some measures to broaden the tax base and has implemented these measures in spite of opposition.

6.1.4. The Capacity to Evaluate, Develop, and Implement Policies

In addition to promoting more effective poverty reduction policies, the PRS process sought institutional changes and changes in governance that would increase governments' capacity to evaluate, develop, and implement policies in general, and poverty reduction policies in particular. We noted previously that, despite the existence of some aid programs to support national statistics, the PRS process has not been able to ensure ongoing structural support for statistical institutes in any of the three countries nor for the regular implementation of surveys essential for monitoring results and impact indicators. Moreover, even when data are available (for example, gender-differentiated data on poverty) the information is not always used in government analysis (Dijkstra 2006). The PRS process has not generated much interest in or commitment to monitoring and evaluating existing programs, by the government, donor,

or civil society (Komives and Dijkstra 2007). The same can be said about the use of instruments like the PSIA (Poverty and Social Impact Analysis) or others. While the PSIA has been used to arrive at some conclusions about the possible impact of policy changes, the initiative normally comes from the donors and it is not clear that the studies have much influence on the design or choice of public policies in the countries that we are studying.

Another common and persistent problem in all three countries is excessive staff turnover, especially when there are changes in government. Of the three countries, Nicaragua appears to have had the least turnover in the technical and administrative staff of the government, but as we will discuss further ahead, recently personnel turnovers has begun to be a problem in Nicaragua as well. The nominal wages of public employees declined in Nicaragua and in Bolivia, and this has led part of the governments' qualified technical staff to leave and find work elsewhere. In both countries, a limit on remunerations to external consultants was also introduced, which also makes it difficult for the government to hire sufficiently qualified temporary technical assistance from consultants. It seems that much of the progress made in previous institutional reforms initiatives has been reversed in the last few years. In Honduras, the history of "clientelismo" in the main political parties makes the quest for stability in the public sector a very important objective, but one that is difficult to achieve. One of the most controversial conditions required by some international financial organizations has been that of making changes to the Civil Service Law. The government justifies continued non-compliance with this condition by saying that the legislative branch has been reluctant to debate such a law. Apart from the previously mentioned turnover in government technical staff, Bolivia, Honduras, and Nicaragua have also had many changes of ministers and vice-ministers during current the administrations, complicating policy development and implementation enormously.

The loss and change of technical staff and high-ranking government officials is probably one of the factors contributing to the problems of efficiency in execution in Bolivia in recent years, but it is important to remember that execution problems existed before the current government. The under-execution of budgeted expenses in Bolivia is a problem we pointed to in the first report of this series. At that time, the problem was more serious at the municipal level for HIPC II resources, which came with some restrictions for their use (see further ahead). For the year 2002, only 52% of the HIPC resources destined for municipalities were spent (Komives et al. 2003: 87). But the problem is not limited to municipalities. In 2003, only 89% of the modified budget of the central government and 79% of the modified budgets of the prefectures were spent (De Jong et al 2005: 70). The execution of the investment budget that year was very low at all three levels of government. According to VIPFE data, only 75% of the budgeted investment resources were spent, doubtless due to the high level of social and political instability. The execution of investment resources has improved since then at the municipal and departmental levels, reaching 127% and 120% respectively for what was initially budgeted in 2006, but the national government has experienced a decline in budget execution capacity, spending only 80% of its resources budgeted for investment in 2006.

In Nicaragua, the under-execution of public expenditures is a recent phenomenon at least at its current level. In the year 2006, an election year in which increases in public expenditures were expected, the public

investment spending was under-executed by amount equivalent to 2% of GDP, or US\$200 million. Public officials at the time attributed this to “technical and administrative” problems. In 2007, at the end of the first semester, only 21% of the yearly amount budgeted for direct investment of the Central Government had been spent. This is explained in part by the turnover in staff that came with the change in government (Guimaraes et al. 2007).

While the PRS process seems not to have contributed to solving these persistent problems in public administration, it, along with efforts to move toward budget support and sectoral support, has brought progress in the development of information systems and national management systems. In our 2005 report, we looked at progress being made in budgeting and financial systems. In 2006 we also analyzed systems for monitoring and evaluating poverty reduction strategies. In general, these evaluations found more significant progress in Nicaragua than in the other two countries, but some progress has been seen in all three countries. Government instability between 2003 and 2005 in Bolivia paralyzed this process for a time, which adversely affected the maintenance of these systems.

This year we noted that, with the change in government in Nicaragua, there is a risk that much of the progress made with these systems may be lost, in part because of turnover in the staff responsible for the systems, and in part because the projects through which the systems were developed have come to an end. In Bolivia, some government actions (such as the decision to give checks to the municipalities) are putting the continuity and integrity of the public financial management and accountability systems at risk.

One interesting development in Honduras this year has been the creation of a results-based management system (SGGR), inspired in a new paradigm of public administration (Total Quality Management, as applied to public sector). Ministers and public enterprise directors establish management goals (with certain results and budgetary execution) that must be met within a certain period. Progress toward the goals is monitored through a computerized system with a system of alerts related to the level of performance. If the system is successful, it could help emphasize the ends (achievements) rather than the means (procedures).

6.1.5. Government Leadership in the Coordination of Foreign Aid

Taking leadership of the relationship with donors is one way that governments can obtain the resources they need for their priorities, to translate their visions into action. Throughout the seven years since the beginning of the PRS process, government leadership in coordinating aid in the three countries has varied a great deal.

In Bolivia in 2001, the government established five working groups (mesas de trabajo) for PRS execution in which international donors participated. But with the change in government, these working groups disappeared (Komives et al. 2003). The government of President Mesa, which began at the end of 2003, once again established five working groups with the participation of foreign donors and civil society. The objective was not the implementation of the existing PRS (which was no longer recognized as a national strategy), however. Rather, the five working groups were organized around the following issues of national priority: a (new) PRS and dialogue; a constituent assembly and referendum; fiscal deficit and budget support; harmonization; and finally, productivity and competitiveness. Progress made in the working groups

depended a great deal on government presence and leadership, which varied from working group to working group. In 2005, the working groups were no longer functioning, though the Fiscal Deficit working group had become the PMAP and was relatively successful (Jong et al. 2005).

The Morales government made an effort to reactivate the working groups with donors in 2006, but very few meetings were held. The (traditional) donors would have liked to have seen the government present concrete sectoral plans to these working groups, which would be elaborated into multi-annual operational plans (POMA), based on which they could either provide aid for projects or in the form of sectoral budget support. They agree that the National Development Plan was not sufficient for structuring aid to sectors. To date, however, the government has been able to finance its priorities with the aid of new donors (notably Venezuela) and some traditional donors (IDB, EC, and bilateral donors to the basic education package) who are not imposing conditions for more planning. This strategy can be considered a form of leadership of the aid process, although it is not the type of leadership that the Paris Declaration stipulates and which many donors prefer.

In Honduras, the Maduro administration, which began in 2002, took some initiatives to ask for sectoral support, for example, in education and health. In March 2003, it organized a coordination workshop with foreign donors and expressed its interest in working towards extending sectoral support to more sectors, particularly in the areas of water and sanitation, agro-forestry, and security. The coordinating groups did not function very well. According to the donors, government leadership was lacking. High level government representatives often did not attend the meetings and there was a lack of ownership of the idea of program support based on sectoral plans. Many government officials believed that this was just a requirement of international donors. In 2005, an election year, the coordinating groups grew even weaker. The Zelaya government made an effort to renew the sectoral groups in mid-2006, but so far there have been no concrete results in the coordination of aid. In Honduras, the government has also been able to finance its priorities with the help of some specific donors, like the Solidarity Safety Net (Red Solidaria) funded by the IDB (De Jong et al. 2007).

In Nicaragua, sectoral working groups existed during the Bolaños government, but their level of performance varied a great deal. According to donors, performance depended on government leadership. It was possible to establish a sectoral plan for some sectors – like education and health and, later, the rural sector. But in education, for example, donors were not very happy with the implementation of the plan, and some wanted to withdraw from the common fund (Guimaraes et al. 2006). The new Ortega government (2007) does not appear to have much interest in reactivating these working groups. Like Bolivia, the Nicaraguan government has been able to finance priorities, like the “Zero Hunger” program, with Venezuela’s support. This can be considered leadership, but not the kind of leadership that the traditional donors would like to see.

In general, we conclude that government leadership in coordinating foreign aid, as envisioned by the Paris Declaration, has been limited for two reasons: first, because of frequent political changes; and second, because of the clash between donors’ ideas about establishing effective coordination and government leadership through broad, multi-annual plans, and the more short-term policies and operations of the governments.

Political changes in the three countries caused ups and downs in coordination processes and especially in the functioning of the sectoral or thematic working groups. They functioned during some years but, in years of instability or election activities, they stopped working. New governments needed time to take ownership of the working groups and, where they existing, of sectoral plans. Furthermore, policy-making processes were not aimed at establishing broad, long-term plans, but rather at forging alliances in favor of short term policies. Politicians are more interested in the short term than the long term and generally do not recognize the plans (national or sectoral) of the previous governments. This means that the requirement for planning carries with it high transaction costs and produces delays in getting government-donor coordination off the ground after a change in government, without producing the expected benefits in terms of more effective aid coordination and more coherent implementation.

6.2. Resources and Expenditures

6.2.1. Does the government have more of its own resources to invest and spend?

The expectation of the HIPC Initiative was that debt relief would free up national resources that could be used to implement poverty reduction strategies. Within this logic, payments that previously would have gone to service the debt could be used instead to cover expenses related to poverty reduction. In practice, there are several reasons why debt relief did not necessarily result in additional resources to spend on poverty reduction.

First, there was the risk that debt relief would be a substitute for other forms of foreign aid, so that there would be no net gain in available resources. This seems not to have been the case in either Bolivia or Nicaragua (before the MDRI), since debt relief has been additional aid. In Honduras, donations declined and the disbursements of concessional credits has fluctuated, though there does not seem to be an overall decreasing tendency. In all three countries, MDRI did result in a reduction of concessional loans from the World Bank.

Second, debt relief would only free up resources to the extent that the countries receiving the relief were making their debt payments before the relief. In Honduras, for example, they were not making all of their debt payments to the Paris Club before the HIPC Initiative. Therefore, not all of the bilateral debt relief was available to be diverted towards other kinds of expenditures. At the same time, the moratorium on debt service to the Paris Club obtained by Honduras and Nicaragua in order to mitigate the effects of Hurricane Mitch was so favorable that when they reached their respective completion points for the HIPC Initiative, they were actually paying more for debt service than they were during the moratorium phase (3 years).

Third, the resources that were expected to be freed up from debt payment to be used for pro-poor expenditures still had to be generated in the national economy. If national revenue declined, governments would not necessarily have “new” resources to invest. Therefore, it was important for the governments to make efforts to maintain or increase national revenue. In Bolivia, revenue fell during the economic crisis of the early 2000s. More recently, changes in the Hydrocarbons Law have produced a significant increase in taxes paid by oil companies and, therefore, on resources available at the national and departmental levels. The sustainability of this flow of resources is in doubt, however. It is likely that

resources from hydrocarbons will begin to decline within two or three years due to the current level of investment in the sector and the fact that the new taxes have decreased the profitability associated with exploiting some of the existing reserves.

In Nicaragua and Honduras, some adjustments in the national tax system have led to an increase in tax revenue. In Honduras, in 2001 revenue was 18.2% of the GDP and, as part of this revenue, tax income was 16.2% of GDP. By 2006, these revenue streams had increased to equal 19.5% and 17.9% of GDP respectively. In Nicaragua, central government revenue has gone from 15.1% of GDP in 2000 to 18.8% of GDP in 2006.

Finally, even when debt relief does create fiscal space that permits additional spending on poverty reduction, this space can disappear quickly if governments acquire new debts, thereby increasing the payments they need to make on these new debts. Of the three countries, Nicaragua is the best illustration of this problem. Domestic debt has increased in Nicaragua due to the property confiscations of the 1980s, central bank losses (due to interest payments and maintaining the value of bonds associated with open market operations), and bank liquidations from 2000 and 2001. Between 2000 and 2006, these factors led to an increase in total debt service as a percent of GDP. It increased from 3.2% to 4.9% of GDP, almost doubling the per-capita cost of this government expenditure (from US\$25 to US\$47).

In Honduras, domestic debt has also increased so that payment on debt service (foreign and domestic) has stayed at around 5% of GDP during the last six years, instead of decreasing with debt relief. From 2000 to 2006, debt service as a percentage of revenue has varied between 31.1% in 2001 and 21.2% in 2002. Even with the increase in domestic debt, however, debt service in Honduras continues to be a much lower burden now than at the end of the 1990s. In 1997, total service on the debt was equivalent to 15.6% of GDP and 92.3% of revenue. In Bolivia in 1997, total debt service was 22.4% of public revenue. Since then, it has varied a great deal, falling to 12.9% in 1999, rising to 19.5% in 2004, and falling again to 10.9% in 2006. These variations have more to do with the variability of revenue (which shows an increasing tendency since 2004) than they do with changes in the debt load.

The overall result of the changes in the last six years is that the three countries today have more resources to spend on poverty reduction than at the beginning of the HIPC process. The continuity of this situation depends a great deal on the future performance of the national economies and tax systems, as well as not replacing debt relief with more non-concessional debt, including domestic debt (as has been the case in Nicaragua). In Bolivia, this situation also depends on the future behavior of the hydrocarbons sector. Nicaragua and, to a lesser degree, Honduras are maintaining their dependency on foreign aid. In annual average terms, during the five year period from 2002–2006, donations and loans (net of debt relief) have financed one-third of total government expenditures in Nicaragua. Bolivia, with its hydrocarbons resources, has a better possibility of acting independently in the future.

Finally, it is worth noting that the additional resources do not translate directly into greater spending power for the central government. The countries have all made commitments to increasing the amount of resources transferred to lower levels of government. In Bolivia, the transfers are significant. In addition to the 20% of tax revenue that is transferred regularly and automatically to the municipalities, most of the

HIPC debt relief is transferred to the municipalities, and a large part of the resources created with the new taxes on hydrocarbons (IDH) goes to the municipalities and departments. Decentralized governments in Bolivia are relatively independent in deciding how to spend their resources, though within prescribed limits in order to keep recurrent expenses from rising too much and with some restrictions on the sectoral allocation of spending. In Nicaragua, transfers made to municipalities were equivalent to 6% of the total 2006 tax revenue, and they will rise one percentage point each year until they reach 10% in 2010. The IMF, however, has demanded a neutralization of these transfers beginning in 2007, which means that the central government is going to transfer a list of projects to be executed by municipal authorities. This will keep decentralization from taking fiscal space away from the central government, but at the same time could also reduce one of the possible advantages of decentralization – the transfer of decision-making power to the mayors.

6.2.2 How have resources been used?

Nicaragua

The Bolaños government has been able to increase both poverty reduction spending (spending on the poverty reduction strategy) and social spending (Table 6.1). This was possible due to an increase in the overall government budget during this period (supported by increased tax revenue and debt relief) as well as a redefinition of poverty spending in 2005 (Guimaraes 2006). But spending was also redirected to social sectors (and away from other sectors) in Nicaragua. In per-capita US\$, spending on education has increased by 50% and in health by 30%; other social spending increased by almost 60%. Spending on education was 4.7% of GDP in 2006 in comparison to 3.8% in 2000. Spending in non-social sectors (excluding security, defense, and debt service) has decreased from 8.7% to 7.3% of GDP.

It seems that President Ortega intends to continue to increase social spending and poverty reduction spending. He inherited Bolaños' 2007 budget, but with some savings, plus debt relief and donations, the new government was able to reallocate C\$1.4 billion in such a way, that among other things, the spending on poverty increased by C1 billion. These resources are for free primary and secondary education, a literacy program, school lunches, free health services, new staff in the health sector, and a transfers to farmers in the Zero Hunger Project.

Not all “poverty reduction spending” in Nicaragua is concentrated directly on the poor. Beginning in 2004, spending on poverty reduction was classified into three categories according to its influence on the income and quality of life of the poor:

- First, the transfer of resources with direct redistributive effects on the income of the poorest groups;
- Second, projects that increase employment and improve the economic capacity of the poor; and
- Third, programs that seek to improve public administration, governance, efficiency in the provision of basic social services, and the business climate.

The hope is that spending in the third category will have a long-term trickle-down effect for the poor, but in the short term, the impact will probably not be very visible. Based on this classification, the conclusion is that poverty spending directed to the poor has decreased (from 56.2% in

2004 to 51.6% in 2006) while PRS spending has increased. This indicates that new poverty reduction spending, or the existing spending that came to be classified as poverty reduction spending in 2005, is less well focused on the poor. In real terms, however, expenditures that fall within categories 1 and 2 have increased.

The increase in spending in Nicaragua has been concentrated on recurrent expenditures. Expenditure on public investment in Nicaragua, as a percentage of GDP, has gone down dramatically from 6.0% in 2001 to 3.8% in 2006 – an annual average decline of 5.9%.

Table 6.1. Nicaragua indicators related to the general budget 2000–2007

Category	2000	2001	2002	2003	2004	2005	2006
	Percent GDP						
Total Budgetary Spending	23.3	22.5	23.0	28.6	25.1	26.0	25.8
Poverty Reduction Spending	–	–	9.1	11.1	12.0	13.1	12.3
Govt. Spending on:							
Education	3.8	3.6	3.9	4.4	4.1	4.5	4.7
Health	3.1	2.8	2.9	3.3	3.0	3.3	3.4
Other Social Expenditures	2.8	2.1	2.1	2.8	3.6	4.1	3.7
Security and Defense	1.7	1.7	2.0	2.1	1.8	1.8	1.8
Other Govt. Institutions	8.7	8.2	6.7	7.0	7.8	7.6	7.3
Service on Foreign and Domestic Debt	3.2	4.1	5.4	9.1	4.7	4.6	4.9
	In US Dollars						
Per Capita Expenditures on:							
Total Budgetary Spending	180	179	176	220	207	232	247
Poverty Reduction	–	–	68	83	95	110	110
Education	30	29	30	34	34	40	45
Health	24	22	22	25	25	29	32
Other Social Expenditures	22	16	16	21	30	36	35
Security and Defense	13	13	15	16	15	16	18
Other Govt. Institutions	67	65	52	54	64	68	70
Service on Foreign and Domestic Debt	25	33	42	70	39	41	47

Source: Based on Data from Budget Reports of the Ministry of the Treasury and Public Credit and for the Central Bank of Nicaragua

Honduras

In Honduras, both public social expenditure and the “PRS spending” or “spending on poverty” are both monitored. PRS spending is a subset of public social spending because it is the expenditure that is best focused on the poor. It does not include: 1) social programs that are not directly aimed at reducing poverty; 2) administrative expenditures of the various government Secretariats; and 3) it limits outlays for the salaries of teachers and medical personnel to a percentage of per-capita GDP. (Anything above that limit is considered outside PRS spending.) On the other hand, PRS spending includes infrastructure programs, primarily aimed at rural areas (roads, irrigation, etc.), which are not included in public social expenditures (UNAT, 2005: 18). Recent reports of the World Bank (2005) and of UNAT (GOH, 2005: 18) show that PRS expenditures in Honduras are more progressive than public social expenditures, as might be expected.

Social spending has increased in Honduras, driven by reconstruction after Hurricane Mitch and later by the PRS. Public social expenditures were approximately 35% of total public expenditures (7% of GDP) in the 1990s, 49% in 2002 (9.9% of GDP), and 51% in 2004 (11.8% of GDP). PRS spending has been equivalent to approximately 8% of GDP since the time it was first measured until now; it was equivalent to 34% of the total public expenditure in 2001 and 37% in 2006. The fact that public social expenditure has grown at a faster pace than PRS spending indicates that much of the new social expenditure in Honduras is being directed to salaries, administrative expenses, and/or programs with little direct relationship to poverty reduction.

Even within the PRS budget, the “salaries” category has grown at the cost of capital transfers and investment (Table 6.2). Spending on salaries is not problematic in itself, but one would like to see that more spending on salaries results in a higher quality of services provided. In this respect, it has been said that: “one vulnerability of PRS findings is that of the 51.0281 billion lempiras spent during the 2001–2005 period, 40% has been spent on salaries – the lion’s share being teacher’s salaries – with no indication to date that the quality of education has improved. On the contrary, even the requirement that teachers spend 200 days per year in class – as agreed between the teachers’ union and the government – has not been met.” (Midence, 2005:55).

The structure of the PRS budget has gone through some changes in the last few years (Table 6.3). The program area called “Investing in Human Capital,” which includes education and health, has increased as a percentage of the PRS budget at the expense of rural poverty, urban poverty, and social protection for specific groups. The area of rural poverty has actually had a real reduction in its budget during this period. With the PRS budget adjustments, the government has prioritized the education sector (44.6% of the PRS budget in 2006), whose impact on reducing poverty will only be able to be seen in the long term.

Table 6.2. PRS Budget in Honduras 2001–2007, by Economic Category

Economic Category	Spent through December in Percentages						Projected
	2001	2002	2003	2004	2005	2006	2007
Salaries	37.2	45.1	43.1	39.8	36.2	41.6	42.6
Goods and Services	7.9	8.3	9.4	9.0	9.8	10.6	14.0
Recurrent Transfers	9.8	10.6	12.7	14.1	20.2	17.5	19.3
Capital Transfers	37.6	30.4	28.9	28.8	28.5	23.0	18.7
Investment	6.6	5.3	4.9	6.6	4.8	7.1	5.3
Loan concessions	0.8	0.2	1.0	1.7	0.6	0.2	0.0
Total PRS (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total PRS (millions L.)	8,755	8,157	9,255	11,356	13,957	14,424	16,459

Source: Midence, 2005:48a (for years 2001 and 2002). Other years are data provided directly by SEFIN based on figures from the General Budget Office and General Office of Public Credit.

Table 6.3. Spending on Poverty, or PRS Spending, in Honduras 2001–2007, by Program

Program	Spent through December and Expressed as% of Annual PRS Budget					
	2001	2002	2003	2004	2005	2006
Human Capital	51.6	61.5	60.9	57.1	57.1	62.9
Education	33.6	40.9	41.1	40.3	36.7	44.6
Health	18.0	20.6	19.8	16.8	20.4	18.3
Sustainability of Strategy	19.7	14.2	13.2	18.5	22.9	21.0
Rural Poverty	17.6	13.4	12.8	13.0	10.3	7.2
Social Protection	5.9	4.6	4.4	4.2	5.5	5.2
Urban Poverty	5.5	5.9	8.6	6.9	4.0	3.3
Economic Growth	0.0	0.0	0.2	0.2	0.2	0.4
Total PRS (%)	100.0	100.0	100.0	100.0	100.0	100.0
Total PRS (Millions of Lempiras)	8,755	8,157	9,255	11,356	13,957	14,424
As Percentage of GDP	8.8	7.5	7.7	8.3	8.8	8.3

Data subject to revision. Source: Midence, 2005:48a (for years 2001 and 2002). Other years are data provided directly by SEFIN based on statistics from the General Budget Office and the General Office of Public Credit.

In terms of the targeting of the PRS spending, an analysis of nearly 90% of what was executed in 2004, showed that:

Of total PRS expenditures, 24.3% is allocated to the first quintile (the poorest) in the distribution. This percentage falls in richer quintiles. However, quintiles 4 and 5 together still receive more than 30% of PRS expenditures, which is a value of more than 3.3 billion lempiras, or more than 1,000 lempiras per year per person. The non-poor receive significant benefits from PRS expenditures in education, health, and even social assistance (GOH, 2005: 4).

In order to improve the focalization of expenditures on the poor, one objective of the PRS in Honduras was to prioritize activities in the most neglected areas of the country. It was not possible to obtain from the Secretariat of Finances statistics on general social expenditures and the PRS expenditures disaggregated by departments and municipalities, which could have shown how well the objectives of improving the spatial distribution of social expenditures are being met. In 2006, the National Congress decided to transfer a part of the HIPC resources to the municipalities using a formula that benefits the poorest municipalities (without excluding the non-poor). To date, the impact of these resources has been limited by implementation problems at the national level and by the weak capacity for planning and execution in the poor municipalities (De Jong et al. 2007).

Bolivia

Bolivia has received US\$638.6 million in debt relief between 2000 and 2006. Unlike Nicaragua and Honduras, there is no record of how all of these resources are being spent in Bolivia. The National Dialogue Law of 2001 defined the use of resources from the HIPC II Initiative, but the HIPC I resources, from bilateral aid “beyond HIPC,”²² and those of the

²² The bilateral aid in HIPC I and II is not very significant in terms of flow, in part because of the problem of the type of options that the Paris Club was offering, but also because much of the debt was incurred after the cut-off date for relief. It was in part due to these problems that bilateral donors decided to give debt relief “beyond HIPC II.”

MDRI initiative are simply part of the resources of the General Treasury and there is no special monitoring of their use.²³ Approximately one-third of the HIPC II resources are being used to pay the salaries of additional teaching, medical, and paramedical personnel. Of the rest of the resources, 10% is a contribution to the implementation of the Universal Maternal and Child Insurance. The other 90% is distributed automatically to municipal accounts based on a formula that gives priority to the municipalities with the highest percentage of poor population and with a low percentage of residents whose basic needs are satisfied. The law establishes that the municipalities can spend these resources on improving the quality of education services (20%) and health services (10%) and by investing in production and social infrastructure (70%). Decisions about specific projects to be funded are made at the municipal level.

At the national level, the concept of “PRS expenditures” no longer exists because there is no poverty reduction strategy as such. There is a monitoring of so-called “pro-poor social spending,” which is part of the social expenditure (recurrent and capital) that has the greatest direct effect on the poor. The pro-poor social expenditure, for example, excludes spending on higher education. Between 1995 and 2006, the % of GDP directed at pro-poor social spending has grown from 9.1% to 13.3%. More than half of pro-poor social spending is recurrent expenditures on education and health. During the years of more political uncertainty, pro-poor social spending in capital fell to less than 5% of GDP, but preliminary statistics indicate that spending levels were recovering in 2006 (Table 6.4). The only social sector that has suffered a real reduction in spending since 2000 is the basic sanitation sector. Spending on urban development, rural development, and local roads has almost doubled since the beginning of the PRS process.

If we look at tendencies in the distribution of capital expenditures in Bolivia between 1995 and 2006, we see that social capital expenditure as a percentage of total capital expenditure rose in the late 1990s, reaching a maximum of 43.9% in 2000 and later falling gradually to 22.6% in 2006, a level almost identical to that of 1995. Capital expenditure on infrastructure (communications, energy, water resources, transportation) show the opposite pattern: they fall around the turn of the century and later rise again, reaching a level of more than 60% of the budget executed in 2006. The significance of spending on productive and multi-sectoral capital investments has dropped gradually during this entire period. In 2006, more than half of all capital investment was dedicated to transportation infrastructure. Agricultural infrastructure is in second place with 10% of the investment budget.

The quality and effectiveness of spending

In sum, pro-poor spending and social spending have increased in the three countries, both in real terms and in comparison with other sectors. But at the same time, there is reason to worry about the quality and effectiveness of this additional expenditure. In Nicaragua and Honduras, the additional expenditure appears to be less well targeted to the poor. The budgets of some important sectors have fallen (rural development in Honduras, and water and sanitation in Bolivia). The three countries have experienced decreases in social capital expenditure. One would need a more detailed sector (or sub-sector) level to evaluate in detail the significance of these changes. But together with our observations about the

²³ Between 2001 and 2003, the origin of the funds used to finance so-called “pro-poor” social capital expenditures was identified, but since then, there has been no monitoring of the origin of the funds used for this purpose.

problems caused per staff turnover, these are indications of possible problems with the quality and efficiency of social and pro-poor spending.

Table 6.4. Bolivia: Pro-Poor Social Spending as Percent GDP

Sector/item	1997	1998	1999	2000	2001	2002	2003	2004 (p)	2005 (p)	2006 (p)
Recurrent expenses	6.1	6.2	6.2	6.0	6.7	7.2	7.1	7.4	7.4	6.9
Health (excluding benefits)	2.4	2.4	2.4	2.4	2.6	2.6	2.7	2.8	3.0	2.7
Health salaries	1.1	1.1	1.1	1.1	1.2	1.4	1.4	1.4	n.d.	n.d.
Benefits	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.3	n.d.	n.d.
Education(excluding university level)	3.7	3.8	3.8	3.6	4.1	4.6	4.4	4.5	4.2	4.0
Education salaries	3.0	3.0	3.1	3.0	3.2	3.6	3.9	3.8	n.d.	n.d.
Other social expenditures	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Capital expenditures	3.9	4.0	4.4	4.8	5.3	5.7	4.8	4.6	5.1	6.4
Health	0.4	0.4	0.5	0.7	0.6	0.7	0.5	0.6	0.5	0.6
Education	1.0	0.8	0.9	1.0	1.4	1.5	1.1	0.8	0.9	1.2
Basic sanitation	1.0	1.0	1.2	1.1	0.9	0.6	0.5	0.8	0.9	0.6
Urban development	0.7	0.7	0.6	0.6	0.8	0.8	0.7	0.7	0.8	1.9
Rural development	0.8	1.2	1.2	1.3	1.7	2.1	1.8	1.6	2.0	2.0
Local roads	0.3	0.4	0.6	0.5	0.7	0.8	0.8	0.7	0.7	0.8
Total pro-poor expenditures	10.0	10.2	10.6	10.8	12.1	12.9	11.9	12.0	12.4	13.3
Pro-poor expenditures in municipalities	0.5	0.6	0.7	0.6	0.7	1.2	1.4	1.5	1.3	1.9

(*) Corresponds to data provided on June 19, 2007.

Source: elaboration based on information from the fiscal planning unit (upf), government general accounts office and vice-ministry of public investment and external financing (vipfe).

6.3. Economic Growth

The economic outlook for Honduras has become more optimistic in the last few years. After some very volatile years in the 1990s and slow growth at the beginning of the new century, GDP grew by 6% in 2006 and projections for 2007 are similar. The international context is looking much more favorable now, but threats persist, including external threats such as dependency on economic activities that are sensitive to changing international environment and dependency on family remittance flows, and internal threats such as institutional weakness, a clientelistic political style, and vulnerability to natural disasters. (De Jong et al. 2007; Cabezas, 2005: 15).

In Nicaragua, the average GDP growth rate has been lower in the last six years than in the final years of the 1990s. Between 2000 and 2006, growth rates have varied between a low point of 0.8% and a high point of 5.3%. In 2006, the growth rate was 3.7% (and 2.4% in per-capita GDP) and a lower rate is expected in 2007. This anemic economic growth has been concentrated in just a few places, especially among intermediary import-export enterprises and in the national financial system. Between 2002 and 2006, both unemployment and under-employment rates rose.

In Bolivia, after some 8 years of 4-5% annual growth rates, the first Asian crisis (1999) and its collateral effects in Chile, Brazil, and Argentina reduced both economic growth (to a rate of less than 2%) and tax

revenue at the same time. Since then, the growth rate has risen again, reaching more than 4% in 2006.

6.4. Poverty and the Millennium Development Goals

Honduras

The 2006 PRS Progress Report in Honduras concluded that, between 2001 and 2005, that the minimal reductions seen in the total poverty and extreme poverty rates were not statistically significant (De Jong et al. 2007). On the other hand, INE household surveys show that total poverty and extreme poverty fell in 2006 and 2007 (Table 6.5), reaching 60.7 and 35.9 respectively at the national level. These achievements are due to economic growth and remittances, not to greater equity in income distribution. In fact, inequality indices are showing that inequality has increased since the beginning of the PRS process (De Jong et al. 2007). This indicates that the social policies and economic policies focused on the poor are having little effect on poverty reduction.

In terms of non-monetary poverty and basic needs, the most recent progress report shows mixed results. Few of the goals related to the first two cycles of basic education, health, and the environment have been met, but there is ongoing improvement in other educational indicators, as well as in indicators for electricity and telecommunications.

Table 6.5 2001–2007 Incidence of Income Poverty in Honduras

Area	Total Poverty							Extreme Poverty						
	2001	2002	2003	2004	2005	2006	2007	2001	2002	2003	2004	2005	2006	2007
National	65.2	64.8	65.1	64.2	65.8	61.8	60.2	48.4	44.8	47.0	44.6	47.1	42.5	35.9
- Urban	57.7	58.2	57.2	58.7	60.3	54.9	55.4	37.8	28.5	29.9	29.1	31.3	25.8	22.4
Central District	56.3	51.4	51.3	51.0	52.6	47.6	49.6	35.0	18.6	20.7	21.3	21.8	17.9	13.1
San Pedro Sula	47.0	49.9	48.7	50.9	50.5	46.1	47.5	25.7	19.3	20.3	20.4	23.7	17.6	15.5
Rest of Urban Area	63.1	64.4	62.8	65.0	67.3	61.4	61.2	44.6	36.5	37.4	35.8	38.4	32.5	29.7
- Rural	73.8	72.3	72.5	70.3	71.0	69.1	66.4	60.6	63.4	63.2	61.4	63.8	60.0	53.4

*Note: Percentage of households whose per-capita income is under the poverty line n.d. Data unavailable
Source: www.sierp.hn; Data from 2006 and 2007 come from INE Household Survey. May 2006 and 2007.*

Nicaragua

According to statistics published by INIDE, between 2001 and 2005 poverty conditions worsened (Figure 6.1) to the point where current poverty and extreme poverty levels are similar to those of 1998. Very large gaps continue to exist between rural and urban areas and between the Atlantic region and other regions. 70.3% of those who live in rural areas are poor compared to 30.9% of those who live in urban areas.

Better news is the fact that the Gini Index, which measures the concentration of consumption and income, has decreased slightly between 1998 and 2005. In addition, in 2015 Nicaragua will probably reach the Millennium Goals of eliminating gender disparities in education and lowering the infant mortality rate to 19 per 1000 live births. Demographic indicators show other improvements of social conditions: an increasing life expectancy, a reduction in maternal mortality (from 107.2 in 2001 to 89.6 per 100,000 births in 2005).

The net primary education rate has stayed more or less the same since 2002 (around 86). In chronic malnutrition among children, there was only a slight improvement in 2005 as compared to 2001. Social security

coverage has expanded between 2001 and 2006 at an annual average pace of 2.97%, but the relationship between the number of people covered vis-à-vis the economically active population continues to be low.

Bolivia

In 2007, the INE published a series of poverty estimates for the years 1999–2006 (See Table 6.6). This series shows that poverty has not changed much between 1999 and 2003–2004 (63%) but it has begun to decline since then.²⁴ The preliminary poverty rate in 2006 is 59.9%.

During the 1999–2006 period, rural poverty has decreased more than urban poverty. While poverty among indigenous people has fallen from 73.1% in 1999 to 69.3% in 2006, the poverty rate of the non-indigenous population has increased slightly (45.1% to 46.0%). The Gini Index (for income) of the total population and the rural population has gone practically unchanged during this period, but there is greater income inequality now in the urban area.

No studies have been published about the progress made towards meeting the Millennium Goals or the PND goals in the last year. As we stated in last year's report, the fourth progress report on progress toward the Millennium Goals indicates that Bolivia has few possibilities of meeting the goals on universal primary education, vaccination coverage, or curing patients with tuberculosis, or of eliminating the literacy gap between adult men and women. The report also estimates that other goals will possibly be met.

6.5. Conclusions

The PRS process has helped to give more attention to the problem of poverty in the three countries, though political discussion on the issue began before the PRS. The current governments in Nicaragua and Bolivia have an ideological commitment to reduce poverty, and in Honduras, the government is almost ready with its revised PRS. In addition, the economic context is favorable, government revenue has increased in the three countries we have studied, and governments have shown in their budgets a commitment to providing more resources to social sectors and their PRS (or PNDs). For all of these reasons, it would seem to be a promising moment for the implementation of poverty reduction policies.

Nevertheless, the experiences in the last seven years point to several problems that have not been resolved by the PRS process and that could adversely affect efforts to reduce poverty in the future. These include problems in planning and implementation capacity, turnover of qualified technical staff, and little effective use of monitoring and evaluation systems. In Bolivia and Nicaragua, the frequent changes in Ministers have also jeopardized the finalization and implementation of the new governments' ambitious plans. Given these problems, it is not evident that the governments are in a good position to implement the policies of the National Development Plans, or a new PRS in the case of Honduras. The capacity to evaluate, propose, and implement new proposals is more important than ever, since the programs and policies in effect have not managed to substantially reduce the poverty rate and even some social indicators have proven resistant to improvement. The small impact of the

²⁴ In the report on Bolivia last year, we worked with the series of most up-to-date data available at the time. This series shows an increase of almost 5 percentage points in the poverty rate in Bolivia between 1999 and 2003 (preliminary data), while the most recent series shows a slight reduction in this rate, which suggests that – according to the most recent estimates – the change was not statistically significant.

PRS on poverty levels is probably in part related to the fact that the strategies still have a very social, rather than productive, focus (at least in their budgets). But we are also worried about the fact that new social spending has not produced the expected improvements in every sector (some sectors have met improvement targets), which raises questions about the quality and effectiveness of social spending.

Table 6.6: Bolivia: Poverty and Inequality Indicators Estimated with the Poverty Line Method by Geographic Area and Ethnic-Linguistic Status (1999–2006)

Geographic area and indicators	1999	2000	2001	2002	2003–2004	2005 (p)	2006 (p)
Bolivia							
Poverty rate (%)	63.5	66.4	63.1	63.3	63.1	60.6	59.9
Indigenous	73.1	76.0	69.4	71.0	70.1	67.9	69.3
Non-indigenous	45.1	54.1	51.9	53.3	49.1	49.7	46.0
Extreme poverty rate (%)	40.7	45.2	38.8	39.5	34.5	38.2	37.7
Indigenous	50.6	56.1	46.0	48.7	42.0	47.4	48.8
Non-indigenous	21.8	31.1	25.9	27.5	19.4	24.2	21.3
Gini index	0.58	0.62	0.59	0.60	n.a.	0.60	0.59
Urban area							
Poverty rate (%)	51.4	54.5	54.3	53.9	54.4	51.1	50.3
Indigenous	60.8	62.2	59.1	60.5	61.7	56.2	58.9
Non-indigenous	40.7	48.2	48.2	48.1	43.7	46.0	42.1
Extreme poverty rate (%)	23.5	27.9	26.2	25.7	22.9	24.3	23.4
Indigenous	30.2	34.1	29.3	31.6	29.0	29.4	31.1
Non-indigenous	15.9	22.9	22.2	20.5	14.1	19.4	16.0
Gini index	0.49	0.53	0.53	0.54	n.a.	0.54	0.53
Rural area							
Poverty rate (%)	84.0	87.0	77.7	78.8	77.7	77.6	76.5
Indigenous	85.8	89.8	81.4	81.9	80.7	80.8	80.4
Non-indigenous	72.1	78.0	64.1	70.2	66.4	65.5	62.2
Extreme poverty rate(%)	69.9	75.0	59.7	62.3	53.7	62.9	62.2
Indigenous	71.8	78.3	65.7	66.7	58.3	67.6	67.6
Non-indigenous	57.5	64.3	38.1	50.1	36.4	45.2	42.8
Gini index	0.64	0.69	0.64	0.63	n.a.	0.66	0.64

(I) Includes capital cities of departamento and el alto.

(P) preliminary.

Note: the criteria of classification for ethnic-linguistic status (indigenous and non-indigenous) takes into account membership and language, together or separately, but understanding language only in its full sense: the person speaks it and also learned to speak it as a child. Therefore, it includes those who say they belong to an indigenous group and those who meet the linguistic criteria even if they don't recognize their affiliation with a particular indigenous group. (Page 191; "gama étnica y lingüística de la población boliviana"; sistema de las naciones unidas en bolivia – ramiro molina b. And xavier albó c.; January 2006).

Source: elaborated with information from the national institute of statistics (national employment survey november-1997; household survey – quality of life measurement program, november–december of 1999,2000,2001,2002; household surveys from 2003–2004, 2005 and 2006).

7. Conclusions and Recommendations

7.1 Changes in Foreign Aid

The volume of foreign aid has varied from year to year, but there has been no increasing trend since the PRS began. Program aid has not increased either, if we compare the 1995–2000 period with the 2001–2006 period. Only in Nicaragua is there a slight increasing tendency in budget support. We do not find a relationship between the existence of an up-to-date PRS and multi-donor budget support agreements. The volatility of aid continues to be high and is greater for program support than for project support.

Conditionality related to program aid has changed in terms of its content: now there is more emphasis on conditions related to poverty (having an approved PRS, pro-poor expenditures in the budget, and conditions for social sectors) but traditional conditionality (in sectors like water, energy, financial sector, foreign trade, and fiscal management) continues to exist. There has been no reduction in the number of conditions as compared to the period before the PRS process. Nor does it seem that conditionality has been modified to give more leadership and ownership over the process to the governments: most conditions are still related to measures that must be implemented and not results that must be achieved; and conditionality often implies micro-management. Little progress has been made in terms of alignment and harmonization. The portion of aid that is given as budget support is still low, and in the few sector-wide approach (SWAp) programs that exist (EFA in Honduras and PRORURAL in Nicaragua), projects with their own management and monitoring systems predominate.

Conclusions in these three countries are similar to conclusions being made about tendencies in aid worldwide. No changes have been seen yet in volatility or selectivity. Conditionality has been maintained, which means that there has been no progress in ownership. This means that one of the basic objectives of the PRS process – that of giving more leadership to the governments and creating more national ownership of the poverty reduction policies through changes in the forms of providing aid – has not been achieved.

7.2 The Presumed Advantages of Program Support

In general, it is very difficult to compare the transaction costs of projects with those of budget support programs. In some ways, transaction costs have decreased for the government. For example, the joint budget sup-

port agreement in Nicaragua has grown, and this means that now there is a common system for preparing, negotiating, and monitoring a significant part (25%) of foreign aid. In some sector-wide programs, a certain level of coordination has been achieved in the form of joint missions or the use of national systems, which has also lowered transaction costs.

At the same time, transaction costs still appear to be high:

- A large part of aid remains outside of national or sectoral budget support programs
- Various budget support systems exist, each with its own conditions and requirements for reporting.
- The number of conditions in the budget support programs, especially in World Bank programs, is high; this means high transaction costs for negotiating the conditions, and in many cases, conditionality is accompanied by micromanagement.
- Sector-wide support programs are rare and those that exist are characterized by the lack of leadership and national ownership, high costs of coordination among donors who participate in various ways with different systems, and some micromanagement on the part of donors in the case of the common funds.
- Political dialogue on budget support, in Nicaragua for example, exists alongside other donor coordination forums; both groups want to talk to the government at the highest level possible, which means duplication of efforts.

Budget support was supposed to be based on the PRS and go through the national planning systems. However, the governments did not take much ownership in the original PRSs. Ownership over the national development plans that followed was greater, but donors were not always in agreement with the priorities included. In addition, the plans were not considered to be operational enough. In the end, budget support programs have not used either the PRSs or the national development plans very much at all.

Budget support or SWAp basket funds generally use national systems for budgeting and financial management, and some successes can be seen in this area. In Nicaragua, the government's financial management has improved, and Bolivia was also making progress in 2005. In Bolivia the donors of the common fund for education were able to improve the financial management in this sector, but, at the same time, they realized that making improvements in this field was difficult at the sub-sector level and that it really requires a national approach.

For monitoring budget support, new systems have generally been created alongside other systems that were established to monitor the PRS. These systems have primarily been created and financed by donors. But donors have not given sufficient attention to supporting the generation of data needed as input for these monitoring systems – a task of the statistical offices of the countries. On the other hand, the governments still have much to do in terms of using available data and in general, they seem to have little interest in doing so.

It is still difficult to reach conclusions about the effectiveness of program support, but it seems that neither the problems associated with project aid nor the conditionality problems of the structural adjustment loans of the 1990s have been overcome. To increase the effectiveness of aid, the modality of aid is less important than the government's commitment and capacity for implementing the financed activities. In terms of

efficiency, coordination among donors and the use of national systems lowers transaction costs for the government, no matter which modality is chosen.

7.3 National Commitment to and Capacity for Reducing Poverty

The three countries studied have more resources today to spend on poverty reduction (and on the social sectors in particular) today than they did in the period before the PRS, and poverty reduction is a common topic in political discourse. In Honduras, the government and other actors in Congress and civil society have taken ownership of the idea of having a PRS. In the cases of Bolivia and Nicaragua, changes in the administrations, more than the PRS process, have contributed to increasing the political commitment to reducing poverty (or “eradicating” it in the case of Bolivia).

The last few years have been characterized by dialogue and debate (at times open and public and at other times closed and technical) about the best social and economic strategies for reducing poverty and about how to define pro-poor spending. In Bolivia in particular, this has led to a discussion about themes that were left out of the first PRS, but that many actors consider to be fundamental to any solution to the poverty problem. Publicly talking about and debating these issues is a significant step in the right direction.

On the other hand, however, discussions about strategies have seldom been based on an analysis of the experiences and results of the programs in progress. In this sense, it is difficult to know whether anything has been learned about the key obstacles to poverty reduction in the past or about how to reduce these obstacles. The proposals for change come primarily from the ideological visions of the new governments (Bolivia, Nicaragua) or from new international ideas (Honduras).

The new strategies have the advantage of trying to address some basic problems such as land, the lack of assets of the poor, and political inequality. But there are also reasons to question the likely effectiveness of the new strategies in the short and medium terms. The vulnerability of the economies to external shocks (and in Bolivia to internal shocks from political and social instability) continues to be a significant risk. Moreover, a large part of the “pro-poor” budgets are dedicated to education, a highly important service, but one whose impact in reducing poverty is, at best, visible in the long term.

Furthermore, it remains to be seen if the current government will have (or will create) the continuity and capacity (technical, political, and management capacity) necessary to translate these ideas into effective programs on the ground. So far, we have seen few significant advances in the area of improving planning and implementation capacity, and some problems have become more serious with the most recent change in government (depending on the country, we can mention turnover in high-level positions, the exit of qualified officials, the lack of continuity with systems, or under-execution problems.) Continuous change in those holding key posts in the new administrations as well as political and social instability in Bolivia have paralyzed or postponed many of the efforts that current administrations would like to see get underway. In general, governments appear to have little commitment to the development and protection of State capacities.

Budget support programs have helped develop many national systems and they have provided an incentive to improve budget processes. They

have not always been able to stop the staff turnover that threatens the continuity of these efforts. Nor have donors or civil society actors made a very credible effort to promote the evaluation of on-going programs. In last year's report, we commented that civil society is more interested in promoting new policy directions, than in monitoring the results achieved with the existing strategies (which they don't feel very committed to). Donors, for the most part, continue to demand that plans be created. In terms of conditionality, they continue to put more emphasis on the measures and processes to be implemented, and less emphasis on the results to be obtained.

7.4 Overall Results of the PRS Process

So what have we achieved with the PRS process? It is of course difficult to draw firm conclusions because we do not know what would have happened had these changes in the aid architecture not been introduced. Nor can we say what might have happened in Bolivia, for example, if President Sanchez de Lozada had received the support of the cooperation agencies for his revised PRS and had not been driven out of power. But the value of these thought experiments is limited because the value of an instrument like the PRSP is tested precisely by seeing to what extent it can be effective in real-life conditions, in this case the conditions in three Latin American countries. We have no reason to expect that the political-social problems in Bolivia will be resolved soon, or to think that the habit of changing staff and priorities each time there is an election will change in the near future. Any effort to improve the effectiveness and efficiency of foreign aid to Bolivia, Nicaragua, and Honduras needs to take into consideration these realities.

That said, it is interesting to compare conclusions about the impact of the PRS process in Honduras (where the PRS enjoyed a longer and less turbulent life) with Bolivia and Honduras (where political commitment to the strategies was short-lived and where serious political problems have paralyzed the government for short periods). If we look at concrete results obtained and the changes in aid, it does not appear that the stability of the PRS in Honduras has helped produce better results in this country:

- The three countries have invested in their social sectors, and have not substantially increased investments in productive projects beyond traditional infrastructure. The three countries have continued to produce improvements in some social indicators, but other indicators have not moved (such as in education).
- With respect to poverty indicators, Honduras shows some improvement in 2006 and 2007, after a period of little movement. But this is due to strong growth in the economy in 2006, more than to the PRS per se: income inequality has increased in Honduras. Bolivia also appears to have achieved reduction in poverty in the last two years thanks to improved growth performance. In Nicaragua, where the growth rates have stayed low, we do not see improvement in poverty (at least with available data).
- Honduras has not benefited from more programmatic aid than other countries, largely because of the mix of donors in the country. In Bolivia and Nicaragua, donors have found ways to provide different forms of program support even with uncertainties surrounding the PRS and the PNDs.

This leads us to question the logic of the PRS process. The existence of a PRS cannot be used as an indicator of government commitment with poverty reduction, and even less as an indicator that the government has the capacity to implement its strategy. Nor does a PRS open the way for the development of long-term aid partnerships. The national strategies generally don't survive a change in government because new governments come in with their own strategies and agendas. Nor do they embrace the majority of the (sub) sector plans put in place before their election. To keep up relationships with governments, the donors have in large measure adapted to the administrations' new priorities.

During this whole period, much time and effort has been invested in negotiating (between donors, civil society and governments) the content of the plans, but much less attention has been given to the implementation of the strategies. This is due in part to the lack of national ownership over the strategies,, the low priority given to poverty reduction in some cases, and political instability in other cases. But there has also been a clash between two mindsets: that of donors with an emphasis on scientific, comprehensive, and long-term planning; and the national mindset of formulating short-term political priorities and trying to achieve them with the political and economic alliances that are available.

Fundamental problems exist with the efforts to move toward governance based on long-term plans. In the past, national planning has only worked in totalitarian countries, and with high costs of inefficiency, because the planners did not have all the information they needed and because bureaucratic control often led to perverse incentives. In countries with a certain level of democracy, like those of Latin America, efforts to reduce poverty are political issues that must be negotiated in order to reach difficult commitments. Donors' efforts to avoid these processes and to try to control or manage results have only led to a lack of coordination between what is written on the paper in the strategies and what is really happening in the country. There is a gap between policies and politics, and between what is written on paper and what is implemented (Gould 2005). In practice, governments continue following their own agendas and priorities, and now they can do it more easily since there is a greater amount of available resources.

One hopes that one of the long-term and sustainable benefits of the PRS process will have been that it promoted and created or strengthened spaces for a continuous dialogue about poverty reduction among national actors. Until now, Congresses and representatives have not participated actively in these discussions, but the prevalence of poverty in political dialogue could still increase. Even then, it will not be easy to overcome the problems related to translated political agendas into effective implemented programs, but it would be good step in the right direction.

7.4 Recommendations

Donors should reconsider the requirement that comprehensive, long-term strategies be created as a basis for receiving aid. Instead, they can evaluate the national development plans created by the governments. To the extent to which there is congruence between the donor and the government on priorities and objectives, donors could support these plans, or part of the plans, for example with highly aligned projects, participation in a SWAp, or with a sectoral budget support agreement..

If this congruence is lacking at the national level, donors can always consider whether there is enough commitment and capacity at the (sub)sectoral or regional/municipal level to implement policies that

promote development in a pro-poor way. In this case, donors can support these efforts.

If there is a minimal level of commitment with the objective of improving budgeting and accountability systems and making them more transparent, donors can provide part of their aid in the form of budget support, preferably through joint agreements and through policy dialogue primarily at improving the financial management of the government.

Donors should avoid micromanagement in country policies. They could provide technical assistance, but only if the government is asking for and showing an interest in it, and in any case, being careful to coordinate technical assistance with other donors.

Donors can seek to provide structural support for some basic functions that would help to execute and monitor poverty reduction policies, for example, for generating statistics related to the Millennium Development Goals in the statistical institutes, for maintaining and improving sectoral information systems, and for strengthening the capacities of agencies (governmental or non-governmental) that monitor government efforts in the area of poverty reduction.

The insignificant achievements in some social indicators (while others are advancing well) suggest that it is time to carefully study the experiences in the sectors that are not making progress. Among other things, our analysis of expenditures suggests that it would be important to evaluate the quality and the targeting of PRS expenditures and the implications of the relative reduction in capital expenditures.

Similarly, the results observed with respect to monetary poverty suggest that the character of growth has not changed in these countries, that the elasticity of growth-poverty reduction is still very low. It is important to look again at growth and at the (new) economic strategies in these countries to see if there has been any change since we looked at pro-poor growth in 2004.

Both the government and the donors need to pay more attention to the question of how to implement strategies through a government system, where the central government is not the only implementer, nor perhaps even the biggest. The most important role for the central government in some cases is to make sure that other governmental entities do their part to reach national goals.

The saying “do no harm” offers another important message for governments and donors: it is necessary to find a way to introduce new ideas and directions based on the institutions and systems that has already been established. This implies using foreign aid (in its different modalities) as well as new national strategies and plans to strengthen existing institutions and systems.

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